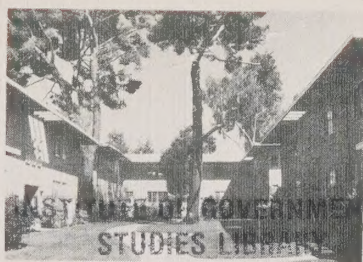


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1988 RENTAL HOUSING REVIEW

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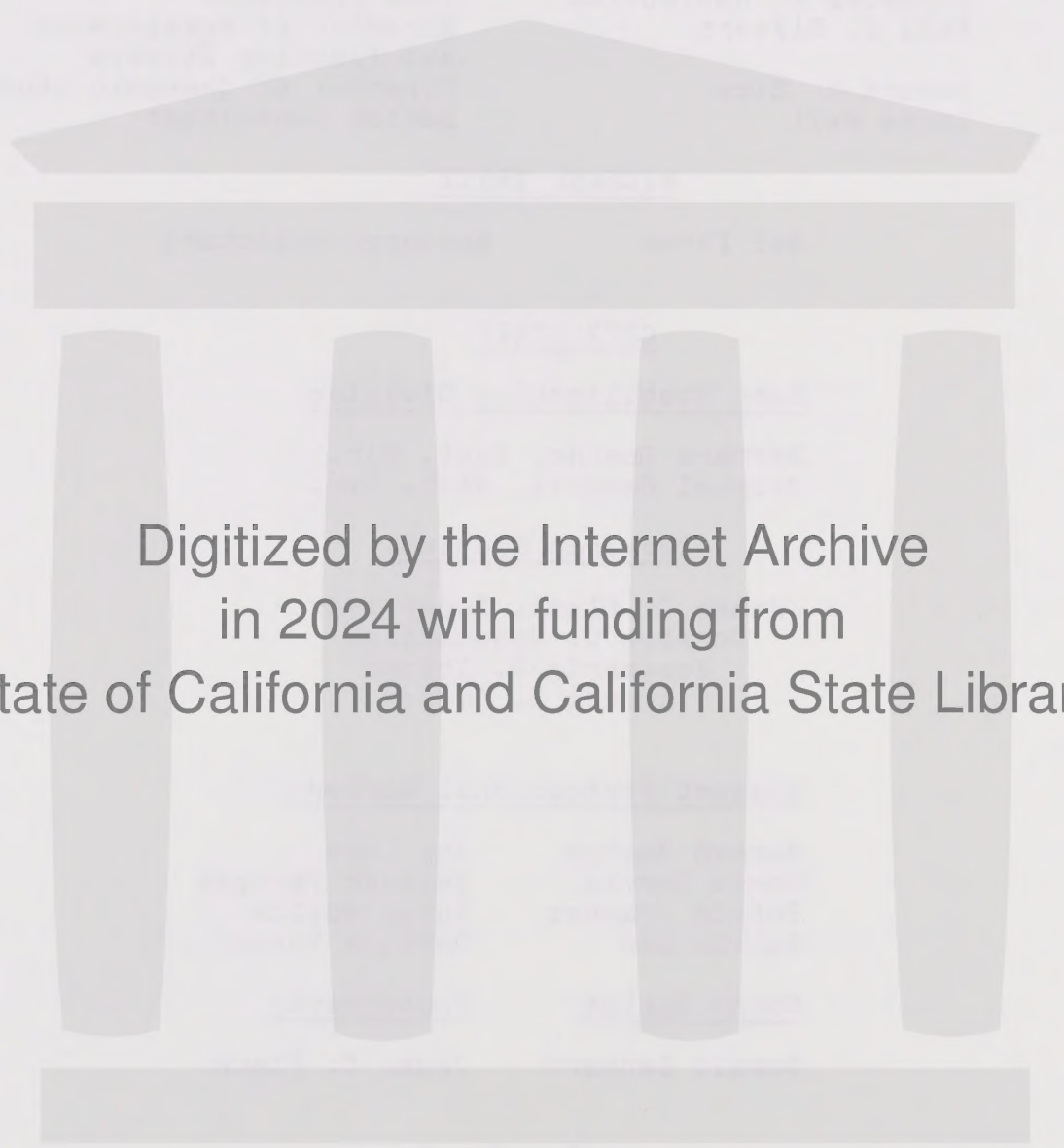
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EXECUTIVE SUMMARY

This Report is the second full-scale review of the impact of the Rent Stabilization Ordinance (RSO) and its predecessor rent freeze that was adopted by the Los Angeles City Council a decade ago. The first review was published in 1985, based on data collected late in the previous year. This study is based on a new data base collected in late 1987. It is designed to provide an updated assessment of the impact of the Ordinance after the Council amended it in 1985 to provide for annual ceilings on rent increases that are keyed to the behavior (within a stated floor and cap) of the regional Consumer Price Index (CPI). The study particularly focuses on the effects of the amended Ordinance upon:

- * Rent levels and the rent-to-income ratios of tenants.
- * The financial situations of building owners.
- * The distribution of the benefits and costs of rent stabilization as between tenants and owners, and as between subsets of each group.
- * The level of maintenance and reinvestment in the stabilized rental housing market.
- * The level of construction of new multi-family housing.

In addition, this study includes special analyses of three issues that have received considerable mention in the current policy debate: (i) the asserted problem of smaller buildings containing concentrations of tenants paying what are termed "historically low rents;" (ii) the impact upon owner finances of major increases in the cost of liability insurance in recent years; and (iii) the tenant demography, rent levels and physical characteristics of the unstabilized stock of rental housing that was first occupied after October 1978.

Key Changes in Backdrop Factors

Although the essentials of the RSO have remained unchanged since the 1985 amendment of the ceiling-setting formula, the demographic and economic environment in the City and the nation have changed considerably. Some of these changes represent continuation of preexisting trends, such as rapid population growth, the shift from migration to births in resident households as the primary driver of that growth, and the simultaneous expansion of both high-tech industries and those which largely employ workers with relatively low levels of education.

Other recent developments represented changes or even reversals in prior trends. Notably:

- * The sale market for single-family homes in California recently entered a period which has been described as a "buyers' panic" of a scale unseen since 1979. This has driven average prices for such homes further and further beyond the means of the average renter household.

- * Mortgage interest rates fell from an average of 11.7% in the year when data was collected for the first review of RSO impact to 8.8% in 1987.

- * Federal tax rules, which formerly contained strong incentives to invest in multi-family housing properties, were amended in 1986 to remove these incentives, thereby decreasing the relative attractiveness of these investments.

- * Important new checks on commercial development appeared, as citizens, elected officials and judges wrestled with conflicting pressures to fulfill growing consumer demand and to respond to concerns about further growth.

Key Developments in the Local Rental Housing Market

Influenced by these and other changes in the economic backdrop, some fundamental indicators of tenant and investor behavior underwent substantial change, as revealed in this study:

- * Average vacancy rates in the rental stock rose from 3.5% in 1984 to 4.3% in 1987, the highest point they have ever reached since the onset of rent stabilization. This was a sign of an easing but still tight market.

- * Tenant mobility, which sharply declined between 1977 and 1984, reversed direction and rose noticeably in 1984-87. Average tenant tenure in a stabilized unit dropped from 5.5 to 4.8 years, and the proportion of tenants that had moved within the prior three years rose from 45% in 1984 to 55% in 1987. Thus, well over half of all the units in the stabilized stock changed hands between the 1984 and 1987 surveys conducted in connection with these reviews.

- * The density ratio of people to rooms in stabilized units rose markedly, from an average of .8 persons to .9. Meanwhile, the share of households estimated to be living in overcrowded conditions (i.e., more than one person per room in the unit) rose from 16% to 21%.

- * New construction of multi-family housing boomed under the pre-1986 tax rules and with the easing of interest rates, increasing by 531% during 1982-86.

Changing Characteristics of the Renter Population

The new survey of rent stabilized tenant households performed for this review identified a number of important continuities and discontinuities since the last survey:

- * An even higher proportion (45%) of Los Angeles tenants did not know in 1987 whether or not their units were subject to rent stabilization (this compares to 41% in 1984).

- * The stabilized population continued to be dominated by households of low to moderate income (their average household income was \$25,931 and 65% earned less than \$30,000 in 1987). Also, their average real income (i.e., income discounted for inflation) fell by about 3% during 1984-87.

- * Households headed by members of minority groups became the majority of stabilized households, as the share of White-headed households dropped from 52% in 1984 to 47% in 1987. But the most significant change was in the share of households headed by Hispanics, who increased their proportion by about two-thirds, as the share of Black-headed households declined.

- * The age profile of the heads of stabilized households was virtually identical in 1987 as compared with 1984. The average age in 1987 was 42.

- * The first data collected on the residents of the unstabilized rental stock occupied since October 1978 revealed a number of interesting contrasts with the 1987 residents of stabilized units:

- # Unstabilized tenant households had 19% higher average incomes than stabilized households (\$30,753 as against \$25,931). The unstabilized households split evenly between those that earned more than \$30,000 and those that earned less.

- # White-headed households were a slim majority (52%) of unstabilized tenants, while Hispanic-headed households comprised approximately the same share of both the stabilized (31%) and the unstabilized (28%) stocks. The second largest minority share of unstabilized units was held by households headed by a member of a non-Hispanic, non-Black minority group, a category which is dominated in numbers by persons of Asian extraction.

- # Unstabilized households were notably younger, on the average, with an average age of 37 for household heads and more than one-third of all heads of unstabilized households under the age of 30.

Physically, the buildings containing unstabilized units tended to be much larger than those containing stabilized units (a median of 20 units, as against 10), and the unstabilized units themselves tended to have more rooms, especially more bathrooms (only one in five stabilized units had more than one bathroom, whereas two in five unstabilized units had more than one).

Behavior of Average Rents and Rent-to-Income Ratios

The 1987 survey revealed that average stabilized gross rents rose much more slowly during 1984-87 (a compound rate of 5.7% per year) than during 1977-84 (10.9% per year). The average monthly gross rent (i.e., rent plus gas and electricity) paid by a stabilized household was \$525 in 1987, compared to \$444 in 1984. (Average rents rose at a higher rate than was permitted by the ceiling on increases in the rents charged to non-moving tenants because more than half of all stabilized units were vacated and re-rented between 1984 and 1987, and the rents charged to new tenants could be marked to market by the building owner.)

The average share of the income of a stabilized tenant household consumed by gross rent in 1987 was 29.2%. This was an increase from 28.5% in 1984, reflecting the fact that average rents had increased slightly faster than inflation, while the average income of stabilized households had risen more slowly than inflation. The average share still stayed below the Federal affordability standard of no more than 30% of income devoted to housing, but 38% of all stabilized households paid income shares above this threshold in 1987, and about one-quarter of them paid more than 40% of their incomes in rent.

The demographic distribution of average rents and rent-to-income ratios in 1987 showed much the same basic pattern as in 1984. Households headed by persons older than 62 continued to have the lowest average rent of any age group (\$436 per month) but the highest average share of income paid in rent (33.5%). Households with the longest tenure in their units had the lowest average rent (\$439), while those who had moved within the last year had the highest (\$601), and the gap between these averages continued to grow. Two-person households paid the highest average rent (\$560), but households of five persons or more had the highest rent-to-income ratio (34.7%). Households with more than \$40,000 in annual income paid the highest average rent (\$666), but the lowest average share of income (15.4%), and the situation was reversed for households earning less than \$10,000 per year.

Despite the general similarity of the 1987 pattern of rent-to-income ratios to that of 1984, some noticeable changes did occur among demographic subgroups:

* The average share of income paid in rent by households headed by a person older than 62 held steady (at a high level), while the share paid by the other age groups increased.

* The average share paid by single-member households fell slightly, while the share paid by households of all other sizes increased. Most of the growth in average ratios was in households of three or more persons.

* The average share paid by households with more than \$40,000 in annual income held steady, while the share paid by all other income groups increased. The average share paid by households earning less than \$10,000 soared to 58% of income.

* The average share paid by households headed by Whites declined slightly and that paid by Black-headed households declined more substantially, while the average share paid by households headed by Hispanics and other minority group members increased sharply.

In the unstabilized household population, for which data were gathered only in 1987, average gross rent was found to be \$675 per month, or 19% more than the average in stabilized units. The average rent-to-income ratio in the unstabilized households was 30.6%, as compared to the 29.2% average in the stabilized population. Only unstabilized households with an income of more than \$30,000 per year reported an average rent-to-income ratio under the Federal affordability standard of 30%.

Rent Stabilization Benefits to Tenants

While difficult to measure with precision, the overall average dollar savings to tenants resulting from rent stabilization were estimated to rise from \$18 per month in 1984 to \$24 per month in 1987. This was the estimated differential between actual rents paid and the rents that would have been paid if rent stabilization had never been adopted. The overall average masked great differences between tenants of different types, particularly as to length of tenure in their units. The data indicated no savings at all for households that had moved within the past three years, whereas those which had been in their units since rent stabilization began were estimated to be saving \$94 per month, or about 5% of their income.

The fact that overall average savings continued to increase was wholly attributable to the City Council's 1985 replacement of the flat 7% ceiling on rent increases with the CPI-based ceiling-setting formula. The flat ceiling would have permitted stabilized rents to rise as fast as the market did, whereas the CPI-based formula held the increase in stabilized rents about one-third lower than the average increase in the unregulated rents charged to new tenants. Analysis of the data indicated that by 1987 the Rent Stabilization Ordinance was keeping the rent paid by about 43,000 households (or 9% of all stabilized households) under the Federal affordability limit of 30% of income which would otherwise be above that limit.

The distribution of rent stabilization benefits among demographic groups was generally similar in 1987 to the pattern in 1984. In both years, households at the high end of the benefit scale tended to be:

- * Middle aged to elderly (virtually all headed by persons over 30, and more than one-third by persons over 62).
- * Low to moderate income (two-thirds under \$30,000 per year and one-seventh under \$10,000).
- * Small in size (nearly three-quarters composed of no more than two persons, and nearly half of one person).
- * Headed by Whites (who accounted for about three-fifths of the long staying households which reaped the highest benefits from rent stabilization).
- * Concentrated in the Hollywood-Wilshire Labor Market Planning Area (which housed about half of the long stayers, while no other LMPA contained as many as one-fifth).

The 1987 data indicated that the average income of the longest staying households, the prime beneficiaries of rent stabilization, grew very little in the preceding three years (\$662 per year, as against an average increase of \$2,700 in all rent stabilized households), and that they suffered an average loss of real income of about 9% during that period.

At the other end of the scale, households that received little or no benefit from rent stabilization, and in some instances paid premiums above market rents, tended to be:

- * Young to middle-aged (nearly half headed by persons under 30 and virtually none by persons over 62).
- * Moderate income (nearly two-thirds under \$30,000, but not many under \$10,000).
- * Small to medium in size (about two-thirds comprised of two persons or fewer).
- * Nearly equally divided between White and non-White household heads (Whites accounted for just over half).
- * Less concentrated geographically (no LMPA accounted for as many as half and the plurality was shifting rapidly from the Hollywood-Wilshire Area to the Valley).

The total dollar savings from rent stabilization for all stabilized households was estimated at \$137.6 million in 1987, a 29% increase from the \$106.9 million estimated for 1984. Despite the fact that households headed by elderly persons received the highest average savings, the fact that there were so many more

non-elderly households in the stabilized population meant that more than 60% of the savings benefits of stabilization were realized by households whose heads were not elderly.

As in 1984, the 1987 survey found that tenants' own estimates of the savings they realize because of rent stabilization was far higher than the statistics indicate. The difference between the rent that tenants who knew their rents were stabilized actually paid and the amount that they estimated they would pay without stabilization suggested a savings volume about five times as high as the statistically-based estimate.

Situation of Building Owners

No existing data base is perfectly representative of Los Angeles landlords. However, data from two sources, the Institute for Real Estate Management (IREM) and the State Franchise Tax Board (FTB) provide a reasonable basis upon which to assess developments in building owner finances. Numbers are available for only one year -- 1986 -- after the Council changed the method of setting ceilings on rent increases, so that firm conclusions are not yet possible. However, the available data suggest that:

- * Net operating income per unit derived from stabilized buildings rose by 8% in 1986 over 1985, a slower rate than the 10.5% that had been the average in the preceding two years, but it was not clear that this could be traced to the change in formula because net income in a sample that included unstabilized buildings also showed a drop in 1986.

- * Because of a sharp increase in average financing costs, the increase in net operating income did not translate into an increase in before tax cash flow, which actually dropped slightly (3%) in 1986.

- * Larger buildings (12 units and more) maintained their average rental income growth in 1986 at the level of prior years (about 11% per year), while smaller ones sustained a reduction (from 11% to 6%) in 1986. However, larger buildings also tended toward larger increases in expenses, so that the smaller ones had bigger percentage gains in net income.

- * Average net operating income per unit rose in all areas of the City except the Northeast LMPA in 1986.

Thus, although expenses increased relative to rental income in 1986, this was true of both the stabilized stock and the total rental stock in the City, and it did not stop average net operating income per unit from increasing. Although the investment and capital appreciation data necessary to make an overall assessment of the change in landlord financial circumstances are not available, the operating data did not indicate any major shifts toward unprofitability during the period since introduction of the new ceiling-setting formula.

The special analysis of the impact on landlord finances of recent increases in liability insurance costs confirmed that these increases have enlarged the share of building expenses that they comprise. However, while this increase was large in terms of prior insurance rates, it still made up a relatively small share of total building expenses. Moreover, the available data indicate that contrary behavior in other expense items has offset the increase in insurance costs, keeping it from being expressed either in higher total operating expenses or in lower net operating income.

Maintenance and Reinvestment in the Stabilized Housing Stock

The 1987 survey of tenant perceptions of the quality of maintenance of the stabilized stock indicated that tenants viewed maintenance as stable and perhaps improving slightly. Nearly 80% of the respondents reported satisfaction with the physical condition and upkeep of their housing, a proportion almost identical to the 1984 response. On the other hand, nearly one-third of the respondents indicated dissatisfaction with the speed of repair and almost as many reported dissatisfaction with their landlords, a higher level of dissatisfaction than was recorded in 1984. When these responses were analyzed, it became clear that dissatisfaction tended to be statistically correlated with length of tenure -- the longer the tenure, the higher the probability of dissatisfaction with housing quality and the landlord.

Review of the available data on landlord expenditures for maintenance and repair indicates that this spending was rising at a lower rate than total operating expenses in 1987, but that this was true in both the stabilized and the unstabilized stock.

Review of the information available with respect to reinvestment in the stabilized stock suggests that the share of it that flows through the City's capital improvement program (which permits a rent increase based on amortization of the cost of the improvement) continued at a relatively constant rate. However, an estimate of the normal needs of multi-family buildings indicated that the great bulk of this reinvestment was occurring without application of the building owner for a rent increase, and was thus financed through ordinary rental income including increases allowed within the normal rent stabilization rules.

Overall, the evidence on maintenance and reinvestment gave no cause for altering the conclusion of the earlier study that rent stabilization has had little if any effect on housing maintenance or reinvestment in Los Angeles.

The Problem of "Historically Low Rents"

This problem is argued to exist in smaller buildings with high concentrations of long staying tenants who were assertedly being charged below-market rents at the time that rent regulation was introduced. The owners of these buildings are alleged to

have failed to take advantage of the onetime rent increase of 13-19% that was permitted to landlords who had not raised their tenants' rents within the 12-24 months preceding the introduction of controls. Thus, it is argued, the rents paid by these households have never been brought to market levels, and the buildings in which they are concentrated are so unprofitable as to threaten maintenance and reinvestment, and thereby reduced housing quality. Moreover, the argument concludes, many of the payers of these substandard rents fall into the category which the earlier study called "unintended beneficiaries" of rent stabilization, i.e., households with annual incomes of more than \$40,000 which were not headed by an elderly person.

When the argument was dissected into five factual propositions which can be tested by the available empirical evidence from the general data base of the study, the following findings emerged:

- * Even if one accepts the questionable assertion that a rent arising from an unregulated market and subject to a onetime correction to remedy timing anomalies is still a below-market rent, the data provided no evidence of systematic charging of such pre-stabilization rents to households that have stayed in place throughout the stabilization period.
- * The data did suggest a slightly higher rate of tenant turnover in larger buildings as against smaller ones, but not a difference that suggests a systematic concentration of long staying households such as to create a widespread problem of historically low rents.
- * There was no evidence of a systematic differential in level of financial performance as between larger buildings and smaller ones.
- * The evidence indicated no systematic difference between larger and smaller buildings with respect to maintenance problems. Though there were some indications that smaller buildings provided lower average housing quality by some measures, these differences disappeared when the analysis controlled for the differential in building age.
- * There was no evidence of systematic difference in the average age of household head or the average household income in large vs. small buildings, as might be expected if there were unusual concentrations of "unintended beneficiaries" of rent stabilization in smaller buildings.

Thus, the general data base provided no reason to believe that a problem of this type existed on any substantial scale.

Nevertheless, in order to test to see whether the overall averages were masking the problem, three associations of building owners were asked to designate a special sample of buildings

where the problem was alleged to exist. A special survey of tenants in units in this sample (93 buildings, 881 units) was conducted. It revealed that:

- * No long staying households (i.e., ones that had been present since the advent of rent stabilization) at all were discovered in half of the buildings whose tenants could be contacted.
- * Only 23% of these buildings contained respondents more than half of whom were long stayers.
- * No more than 16% of the buildings containing respondents to the survey could possibly have been filled to capacity by long staying households.

In addition, face-to-face interviews were held with all or most of the tenants in 11 of the buildings in the special sample. These interviews established that none of these buildings was entirely filled with long stayers, only 18% of them were more than 50% filled with long stayers, and that 27% of them had no long stayers at all.

In sum, no empirical evidence of a historically low rents problem of any dimension was found. Although isolated instances of such concentrations may exist in some buildings, it seems quite unlikely that they are of sufficient number or intensity to threaten any appreciable long-term deterioration of the stabilized stock.

Consultants' Policy Recommendations

The City asked for the consultants' policy views as one of many inputs that the Council will take into account in its deliberations with respect to the Ordinance. These recommendations, which are necessarily subjective in nature, are as follows:

- * The current CPI-based formula for setting ceilings on rent increases in the stabilized stock should be retained, together with the other rules and principles that make up the current Los Angeles rent stabilization regime. The ceiling has worked demonstrably better than the prior flat ceiling, and its flexibility may be even more important in the future economic climate than it has been in that of the past three years.
- * No general exception should be made for concentrations of historically low rents. However, a non-retroactive adjustment of the size originally provided in the provision of the Ordinance designed to remedy timing anomalies should be granted to landlords who can show that (i) although entitled to it, they did not take advantage of the onetime adjustment at the beginning of rent regulation; (ii) the tenant in the subject unit has not vacated the unit during entire life of the stabilization program; (iii) the tenant has been charged

the maximum allowable rent increase in every year of that period; and (iv) at least half the units in the building have experienced the same phenomenon. If granted, this adjustment should be phased in over three years so as not to inflict undue hardship on the tenant.

* No change should be made in the current rules dealing with capital improvements.

* Though the massive average share of income paid in rent by households with annual incomes of less than \$10,000 is a matter of rightful policy concern, the City should not attempt to deal with the basic problems of poverty by manipulating the rent stabilization rules. To attempt to do so would disrupt the delicate balance between tenant protection and landlord maintenance and reinvestment incentives that the Ordinance is designed to achieve.

* The factors most deserving of more careful monitoring than is already the case are (i) the behavior of housing density (i.e., number of persons per room); and (ii) the rate of new construction, which is probably now out of the boom stage and is unlikely to provide the market outlet that it has during the past three years.

* So long as the City elects to maintain a rent stabilization regime of the current general design, reviews of the impact of the Ordinance should be conducted at intervals of not less than three or more than five years. In preparation for the next one, three data/analysis problems deserve special and in some cases immediate attention:

Development of a data base on landlord finances that is more representative of owners of stabilized buildings of all types within the City of Los Angeles than are any of the existing sources of data.

Development of a more textured standard against which to measure the benefits of rent stabilization.

Expansion and continuation of the gathering of information on the unstabilized stock, which is necessary to make a rounded assessment of events in stabilized rental housing.

1988 RENT STABILIZATION REVIEW

CHAPTER 1: PURPOSE AND CONTEXT OF THE STUDY

Introduction and Statement of Purpose

Most of the multi-family rental housing in the City of Los Angeles has now been subject to rent stabilization for ten years. The first comprehensive review of the effects of the stabilization program was conducted based on 1984 data and published in the spring of 1985.¹ Through a sequence of actions described below, the City Council ordered a second review to be conducted during the first half of 1988. This Report provides facts, figures, and analyses of a new base of data collected in the latter part of 1987. Like the initial study, it examines the impact of the Rent Stabilization Ordinance (RSO) on tenants, on owners of multi-family residential buildings, and on the construction of new multi-family housing. In particular, it focuses on changes in impact between late 1984, when the initial data were collected, and late 1987, when the data for this second review were gathered.

¹Hamilton, Rabinovitz, Szanton & Alschuler, The Rent Stabilization System: Impacts and Alternatives (City of Los Angeles, Community Development Department, Rent Stabilization Division, April 1985), and Rent Stabilization Division, Housing Production and Performance under Rent Stabilization (City of Los Angeles, April 1985).

The earlier study was designed to enable the City Council to evaluate alternative formulas for setting maximum allowable annual rent adjustments to replace the flat 7% ceiling on annual increases that had been in effect since 1979. On May 30, 1985, in the aftermath of publication of that study, the City Council amended the adjustment procedure to permit annual rent increases up to the level of general price inflation in the regional economy, so long as that annual inflation rate is no lower than 3% nor higher than 8%. This policy has thus far usually produced annual ceilings on rent increases of 4% per year, though in one year the ceiling was 5%.¹

¹More specifically, if the same tenant continues to rent a unit built before 1978, the rent may be annually increased without the permission of the Rent Adjustment Commission or the Rent Stabilization Division (RSD) by a percentage equal to or less than a ceiling percentage share that is set annually by RSD. This share is based on the change in the monthly average of the regional Consumer Price Index (CPI) during the 12-month period that ends on September 30 of each year, unless that change is less than 3% or more than 8%. If it falls outside these limits, the ceiling is set at the appropriate one of these lower and upper bounds. The allowable annual adjustment, the amount of which is announced in November, may be applied once and only once to any rent for which the increase first becomes effective on or after the following July 1. If the rent is not increased by the full amount allowed, the difference between the increase and the ceiling does not remain available for use during the remainder of the year, nor does it carry over into any future year. In fact, the behavior of the CPI has been such that the upper and lower bounds have never yet come into play. The annual ceilings on rent increases promulgated by RSD since the amendment of Ordinance have been as follows:

YEARS	PERCENTAGE INCREASE ALLOWED
7/1/85 - 6/30/86	4%
7/1/86 - 6/30/87	5%
7/1/87 - 6/30/88	4%
7/1/88 - 6/30/89	4%

In February 1986 the City Council specifically required that the RSO be reviewed again between January 1, 1988 and June 30, 1988, primarily to provide a snapshot of the impact of the Consumer Price Index (CPI)-based rent adjustment formula in operation, as compared to the prior impact of the flat 7% annual adjustment.¹ The current study is largely devoted to this purpose.²

Summary of the 1985 Findings

Readers of the the first study will recall that it concluded that by 1984, after six years of stabilization, overall average rents in Los Angeles' stabilized housing stock were not significantly different from those in surrounding cities which had not

¹The Ordinance (#156597, LAMC 151.19) mandating a detailed review of the impact of the Rent Stabilization Ordinance was actually enacted on May 20, 1982, and originally provided that the review occur between January 2, 1986 and June 30, 1986. However, much of the data and analysis that this Ordinance sought were provided in the 1984 study, which was later authorized by the Council. Since the major change in the program after 1982 was the tying of the annual ceiling on rent increases to the behavior of the CPI, which change would have been in effect for only half a year by January 1986, the Community Development Department (CDD) requested that the Council delay the review until 1988. See CDD Report of July 5, 1985 to the Council's Governmental Operations Committee entitled "Revisions to the Rent Stabilization Ordinance." The Council approved the delay through Ordinance #160791, adopted on February 7, 1986.

²There is one major area of housing policy which falls under the RSO which is not examined here because it is the subject of a separate Report. This is the regulation of rents in Single Room Occupancy Hotels (SROs). That topic is treated in detail in a companion Report: Hamilton, Rabinovitz & Alschuler, Inc., The Economic and Financial Structure of Single Room Occupancy Housing in Los Angeles. (Community Development Department, Rent Stabilization Division, 1988).

undertaken to regulate rents.¹ However, the study also found that rent stabilization had provided distinct financial benefits to certain types of tenants, which were financed largely from higher costs to tenants of other types. By far the most important distinction between the types was length of tenure in the unit. Tenants with relatively long tenure averaged rent savings of between \$47 and \$55 per month below unregulated rents, which was equivalent to 2-3% of their average income. Some members of all demographic groups in the City received these benefits. However, because longer tenure was more associated with some demographic characteristics than with others, the tenant groups that were the most frequent beneficiaries were those who were of low to moderate income, White, elderly and members of single-person households.² Conversely, the groups who most frequently paid higher-than-unregulated rents were those with incomes of \$10-30,000, of minority extraction, younger and members of larger households.

¹It should be noted that the study indicated that this rough equivalence would not have existed at various points in time before 1984. The flat 7% ceiling that governed rent increases throughout the period 1979-84 had resulted in some years when increases permitted in the City lagged behind those that occurred in surrounding unregulated rent environments, and other years in which Los Angeles rents were permitted to "catch up" through larger increases than occurred in unregulated areas. By 1984, the study found, regulated and unregulated rents in the area had approximately equilibrated in terms of overall averages, but this was largely attributable to the timing of the study and its relation to the unprecedented lurches of the most convulsive inflation/deflation cycle in American peacetime history.

²Despite the fact that the elderly were the most frequent age group beneficiary of rent stabilization, the study also showed that they paid a larger share of their average income in rent than any other age group.

The 1985 analysis also concluded that the rates of return to owners of residential buildings had not been significantly lowered as a result of rent stabilization, either when compared to the return rates earned in Los Angeles in the pre-rent stabilization period, or to those in surrounding cities without rent stabilization. Although rates of return to owners did fall sharply in the initial period following the adoption of rent stabilization, the study showed that in later years returns in Los Angeles exceeded those realized in non-stabilized cities in the area. One commentator later noted that "the latter result may well have occurred as a consequence of low levels of vacancy and the growing awareness by investors that the system was being operated in a way that did not primarily favor either landlords or tenants."¹ Whether or not for that reason, the results did not suggest that rental housing had become a significantly less remunerative investment in Los Angeles as a result of adoption of rent stabilization if viewed over a six-year period, though the conclusion would have been quite different if the analysis had been conducted only two or three years after adoption.

The 1985 study also found that, while most indicators of housing deterioration were increasing in Los Angeles in the years after the adoption of rent stabilization, the decline in these

¹Michael B. Teitz, "Rental Housing Regulation in California: What Do We Know?", in Rental Housing in California: Market Forces and Public Policies, ed. L. Graymer, J. DiMento and F. Schnidman (Oelgeschlager, Gunn & Hain: Boston, 1987) p. 89.

quality indicators was even greater in surrounding non-stabilized cities. This suggested that, though declining quality was a clear and present problem throughout the area, it was not significantly worsened by any measurable building disinvestment effects of rent stabilization.

Rent stabilization also appeared to have had little effect on construction of new multi-family housing. Developers and investors seemed to have discounted what they apparently regarded as a modest additional risk of building in a system where a stabilization ordinance existed, and had continued to reach positive conclusions about building in Los Angeles as a consequence of their overall calculations of the probable return on competing uses of their capital.

Focal Issues of the 1988 Study

This study first examines these issues anew in the light of more than two years of experience under the rent adjustment formula adopted in 1985. It addresses five central questions:

- (1) What effects has stabilization had on rent levels?
- (2) What is the distribution of benefits and costs, as between owners and tenants, and as among subsets of each group?
- (3) What have been the effects on rates of return to owners?
- (4) How has the housing market performed with respect to maintenance and reinvestment in the housing stock?
- (5) What has been the impact on construction of new housing?

In addition to examination of these five central questions, this study addresses certain other, more specialized issues concerning which the City has expressed a desire for data and analysis. These include the following:

(1) Housing with "Historically Low Rents". Some assert that owners of smaller properties are now experiencing financial problems because their buildings contain a majority of units that were at very low rent levels in May 1978 -- the level at which the RSO initially froze rents and then regulated increases from that level -- and most of the tenants then in these units are still there. Owners concerned about this problem have proposed that a special, one-time upward adjustment in allowable rents be permitted for buildings which meet this description. During the spring of 1986 the Rent Adjustment Commission (RAC) conducted a series of public meetings to obtain information about this problem, but then recommended that no change in the Ordinance be made. This study includes a special analysis of this sector, which is generally referred to as comprised of buildings with "historically low rents."

(2) Impact of Insurance Costs. Many building owners maintain that property owners have, since 1984, been faced with major cost increases because of fast-rising premiums for property/casualty insurance, increases which far exceed the rate of increase in the CPI. They believe that these increased costs should be reflected in a one-time upward adjustment in allowable rents under the rent increase formula. This study therefore contains a special analysis of the impact of liability insurance costs on operating expenses and net operating income in Los Angeles residential buildings.

(3) Changes in Rent-Income Ratios and Scope of RSO Coverage. Some tenant organizations argue that the financial situation of tenants is deteriorating because the monthly rent for housing throughout the City is rising more rapidly than their incomes. In addition, they argue that, although the RSO initially covered the vast majority of rental housing in the City, a smaller and smaller portion of the rental stock now falls under the RSO. This study includes a description of the rent, tenure and demographic characteristics of tenants in the non-stabilized stock, as well as of those in the stabilized stock. It also analyzes trends in Citywide rent levels for housing, including stabilized and non-stabilized units, whether the latter preexisted adoption of stabilization or have been constructed since then.¹

¹All units constructed after October 1, 1978 are exempt from coverage by the Ordinance, as are all that commanded rents which on May 31, 1978 fit within a definition of "luxury" that was

One special data collection and analysis effort that was performed in the 1985 study, that concerning mobile home parks, is not repeated in this review. And, there are some significant differences in the methods employed in the course of this work as compared with the last review.² Nevertheless, we believe that the 1988 findings are subject to valid comparison with those of 1984, and that the comparison forms an important part of the information base that should be reviewed by City authorities in their deliberations on future rent regulation policy.

Changes in the Rent Stabilization Ordinance Since the 1985 Study

Except for the crucial 1985 shift from a flat to a CPI-based ceiling on annual rent increases, the current Los Angeles Rent Stabilization Ordinance is essentially unchanged from what it was

specified in the Ordinance.

²The chief differences in methodology are two. First, the 1985 analysis used as one (of its two) simulations of what rents would be in Los Angeles if rent stabilization had not been enacted the results of a survey of rents in surrounding cities that do not regulate rents. Because of the difficulty of establishing the true degree of comparability between jurisdictions, this survey has not been conducted again. Three other techniques for estimating unstabilized rents have been substituted and are described later. Second, the 1985 study based its conclusions about owner situations largely on an intensive questionnaire/interview survey of owners, cross-checked by data from the State Franchise Tax Board (FTB) and from the Institute for Real Estate Management (IREM). Because of the very high cost and other difficulties involved in such a survey, it was not repeated this time around. The analysis of owner circumstances in this study rests primarily on updated FTB and IREM data.

when the data for the earlier study were collected in late 1984. Then and now, the basic features of the Ordinance are the following:

- * Limitation on the amount and frequency of rent increases for non-vacant units.
- * Non-limitation of the rent charged to a tenant moving into a vacant unit following either voluntary quittance by the previous tenant or, in most cases, a "for cause" eviction. Limitations subsequently apply to the rent charged to the new tenant household until such time as it vacates the unit in one of these ways.
- * "Just cause" requirements for eviction, under which specified grounds are required before a building owner is permitted to evict a tenant.
- * Coverage of most multi-family buildings occupied before October 1, 1978, but exclusion of:
 - # All multi-family building units built after that date.
 - # All single-family residences.
 - # All multi-family building units that rented for amounts above specified dollar levels (defined as "luxury units") on May 31, 1978.

To say that there has been only one major change in the essentials of the Ordinance, however, is not to say that there have been no other changes at all. In addition to the shift to a CPI basis for adjusting the ceiling on rent increases, the City Council has adopted three other refinements of the Ordinance since the earlier review of the program's impact. Though these changes are unlikely to have had major impact on the questions of system impact which this study is designed to examine, they did alter the aspects of the stabilized market at which they were

aimed, and the reader may wish to bear them in mind in reviewing the study results. The three additional changes were the following:

* Relocation Assistance to Tenants. In February 1986 the Ordinance was amended to require payment of monetary relocation assistance by building owners to tenants evicted for what are commonly called "no-fault" reasons. Such reasons include owner occupancy of the unit, major rehabilitation or demolition, and permanent removal of a rental unit from the housing stock. This program is similar to the relocation assistance program for condominium conversions.¹ The monetary assistance required was initially \$1,000 or \$2,500 per unit depending on the status of the tenant. It was raised to \$2,000 or \$5,000 per unit in August 1987.²

* Limits on Density Per Unit. In December 1986 the City adopted specific minimum room sizes and limits on the number of inhabitants who may occupy a unit of a given size, as well as safeguards for tenants with respect to administration of these rules.³ The RSO was amended to require building owners to give written notice to tenants of the maximum number of occupants of each tenant's rental unit, and to offer a comparable unit which would resolve the overcrowding problem if the owner seeks to recover possession of the unit because the number of occupants exceeds the occupancy standard. The limits set by this provision still permit very

¹However, the conversion assistance program, which always involves all of the tenants in the building, requires the owner to establish a systematic program to help tenants to find new housing. In contrast, the program described here usually involves only a small number of units, so that the owner is not required to establish elaborate procedures to seek out other housing for the relocating tenant(s).

²Building owners now also have the right to put relocation assistance into an escrow account to insure that the tenant vacates the unit promptly following payment of the assistance.

³The change was adopted in order to bring the City into conformity with State laws limiting the number of occupants in a dwelling unit. These limits are based on the square footage of the unit. The City adopted an amended version of the standard contained in the Uniform Building Code, which requires that every dwelling unit have at least one room of not less than 150 square feet of floor area and that other rooms be not less than 70 square feet. It also stipulated that 50 square feet of floor area be provided for each occupant in excess of two in such rooms.

considerable density, however, and seem unlikely to make a substantial change in the behavior of the market for rent stabilized housing.¹

* Exemption of Additional Mobile Home Sites. The Council acted to exclude from RSO coverage all new mobile home parks and pads, and pads and coaches added to an existing park, after October 1, 1978.

These three refinements continued the Council's effort to fine tune the Ordinance but, as noted above, they seem unlikely to have affected the overall balance that Ordinance establishes between protecting tenants against unreasonable rent increases or evictions and allowing building owners a reasonable return on their property. Although a number of proposals have been made in the City Council that might well have resulted in shifts in this basic balance, the Council has generally kept to its stated goal of amending the RSO only at periodic intervals after major factual review of the kind reported on in this document and the others that accompany it.

The Changing Demographic and Economic Environment for Rent Stabilization

Any assessment of the impact of the rent stabilization program must be made in light of the fact that the housing market in Los Angeles is responding to some striking and in some instances unique demographic and economic forces. The City is

¹Since two people may sleep in a 70-square-foot room, 120 square feet is required for three and so on, a one-bedroom apartment with 190 square feet of living space could legally house five adults.

part of a regional metropolitan area inhabited by more than 12.6 million people, comprising Los Angeles, Orange, Ventura, Riverside and San Bernardino counties.¹ This region has grown rapidly for four decades and shows little sign of losing its attraction to people and businesses.² Indeed, it may contain 14.7 million people by the year 2,000 if current projections are correct. The City of Los Angeles, which contained more than 3.2 million people in 1987, has grown at a rate of about 1.2% annually since 1980.

The resilience of growth in the City of Los Angeles, somewhat unusual in a maturing megacity, is driven by two major demographic influences. The first is natural population increase. After many decades of population growth driven primarily by migration from the rest of the U.S., the City now generates most of its new population -- about 80% of its increase

¹Although this is not the traditional definition of the region for Census purposes, it is the region defined by Los Angeles 2,000, a group of citizens and public officials who have joined together at the request of Mayor Bradley to think about the future of the City in the context of the region. The group has amassed an impressive body of statistical evidence to the effect that most of the more important public policy problems of Los Angeles can only be usefully conceived and addressed in a manner that takes their regional character fully into account. Except where otherwise noted, the description here is based on data presented to this committee and reproduced in its 1986 Annual Report and its 1987 Interim Report.

²It is true that there was a five-year interruption, and even a mild reversal, of this growth trend with respect to Los Angeles County, taken alone, during the years 1970-75. This fact gave rise to many projections that forecast very slow growth through the remainder of the Century. In fact, however, the long-term growth trend in the County resumed after 1975 and there is no reason to believe that it will not maintain its current pace through at least the year 2000.

since 1980 -- from the fertility and new household formation of its own households. Indeed, on balance, the City is now exporting population to other parts of the area and the country, rather than serving as a net receiver of migrants.

Second, however, the loss of migration from other parts of the nation has been offset not only by natural increases but by an extraordinary burst of international migration, primarily from Latin America and the Pacific Rim. There are few reliable measures of the extent of this in-migration, but it has been estimated to have provided between 30,000 and 60,000 new residents to Los Angeles in each of the last five years.¹ These new entrants into the City are varied in their national origins, income and educational status. They are profoundly changing the character of the City and its housing markets in many ways. For example, Hispanic migrant families are thought to be larger and younger than the average family already residing in Los Angeles, with the result that a prior long term trend toward smaller household size has probably been at least offset and in many subareas of the City reversed. Meanwhile, Chinese, Vietnamese and Korean households have grouped together for mutual support, transforming whole areas and housing submarkets in terms of both

¹Briefing Book for the Blue Ribbon Committee for Affordable Housing, Housing the Future, City of Los Angeles, 1988, Prepared by the Housing Coordinator, Office of Mayor Tom Bradley, Section 4.5, "Immigration."

residential and economic structures. Thus, at present Los Angeles presents one of the most complex and dynamic social and ethnic compositions in the United States.

Moreover, transformation has not only taken place in the demography of the City. Its economic base has been shifting at the same time. Los Angeles has succeeded in simultaneously participating in and resisting the most powerful trends that have affected the economies of most large American cities. As elsewhere, service employment has grown rapidly, particularly in the financial and business service sectors. This trend has transformed the Downtown area and created whole new clusters of high rise development and employment. But, at the same time, Los Angeles has not lost manufacturing employment, as most large cities have, even though some of the City's traditional manufacturing sectors have declined.

Manufacturing employment in Los Angeles has been stimulated in two quite opposite directions. High technology and defense industries have created large numbers of jobs and attracted educated and technologically sophisticated workforces with high incomes, as well as lower paid assembly workers who seek more traditional jobs. Simultaneously, the influx of lower skilled migrants has made feasible the development of low wage employment

in sectors such as apparel and shoe production. These activities, which have elsewhere been moving offshore, have enjoyed a boom in Los Angeles, reinforcing the magnetic force for in-migration.¹

In the 1980s, when combined with the effects of the deepest recession and the longest recovery of the post-World War II era, these demographic and economic changes have exerted varying degrees of stress on the local housing market. The market for single family homes, the most closely watched indicator of housing cost behavior, has alternated between periods of relative sluggishness and periods of brisk demand. Most recently, the sharp drop in demand that followed the stock market crash of October 19, 1987 has given way to what the Wall Street Journal has described as a Statewide "buyers' panic" of an intensity unseen since the last of the several demand surges that occurred in this market in the 1970s.² The President of the San Fernando Board of Realtors describes the current demand for single-family homes in the Los Angeles area as "simply ravenous." The Journal also cites evidence of the large price increases which one would expect to emerge in the face of runaway demand.

¹See Housing the Future, Section 3.10, Labor Market Trends.

²Wall Street Journal, "Buyers' Panic Sweeps California's Big Market in One-Family Homes," June 1, 1988, p. 1. The story says that the last "panic" of this dimension in California occurred in 1979.

In the bulk of the decade which preceded this demand rush, however, it is unclear just how much stress was placed on the housing market, or how this stress translated into ratios between the growth of housing costs and that of household incomes. This unclarity is particularly present with respect to residents of the City, for whom there are no recent data on point.

The data for Los Angeles County as a whole indicate that single-family house prices appear to have risen somewhat more slowly than income in recent years. The average cost of a single family dwelling in the County went from \$101,089 in 1980 to \$112,709 in 1983, an increase of 12%. The average then rose to \$131,644 in 1986, a further increase of 17%.¹ Meanwhile, using an inclusive definition of household income developed by the Center for Continuing Study of the California Economy -- a definition which includes in-kind benefits as well as money income -- average household income in the County rose from \$31,819 in 1980 to \$39,088 in 1983, an increase of 23%, and then to \$47,486 in

¹California Association of Realtors, California Real Estate Trends, monthly.

1986, a further increase of 22%.¹ In the County as a whole, therefore, these figures indicate that the average relation between total resources received by a household and the cost of a single-family house has, at least until very recently, been dropping at a non-trivial rate during the 1980s.

However, there are crucial differences between the City and the County as statistical universes. First, the majority (60%) of City households are renters, not homeowners, while the County is split almost evenly between the two groups. This is critical because, according to the Census, the average household incomes of homeowners ran more than twice as high as those of renters in both the City and the County in the last year (1979) for which comparative data are available. Second, average single family home prices for the County include many new developments built on empty and relatively inexpensive land, whereas comparable figures for the City would largely reflect in-fill and replacement housing on relatively expensive land. It seems at least questionable, therefore, that the ratio between the average incomes of

¹California Counties Data Base, Annual Economic and Demography Profiles, Center for the Continuing Study of the California Economy. It should be noted that these figures are based on the personal income reports issued annually by the U.S. Department of Commerce, which the Center then amends to add in non-monetary forms of household income. The figures in the Commerce series usually differ considerably from those reported by the Census, and many authorities regard the Commerce numbers as more reliable because of suspected chronic underreporting to the Census. The reader should be aware, however, that the Center figures quoted here for 1980 run about half again as large as the average household income for the County reported in the 1980 Census. If Census figures existed for the other years mentioned, which they do not, it is likely that the same difference would occur.

City dwellers and the average price of single family homes in the City has been dropping. And, perhaps even more important, it is doubtful that most City renters, for whom the Census-reported 1979 average income was \$14,378, are in an income bracket where the purchase of a single family home is even a remotely live option.¹

These factors reinforce the strong, though statistically unprovable, impression of most observers of the City economy that, particularly for younger renters, the race between income growth and growth in housing costs has been so close that many households which once might have been accommodated through single-family home ownership have long been spilling over into the rental housing market in Los Angeles. This would mirror the situation that many students of the housing market associate with California as a whole.² If this perception is correct, the price

¹The California Association of Realtors publishes a monthly index tracking the annual income that would be necessary for a household to afford the median-priced house sold in the State. In April 1988 this index indicated that such a household would need an annual income of \$48,709 in order to carry a 30-year mortgage on the median-priced home sold in that month, which cost \$157,033. The Association said that this would put the home within reach of only 29% of the households in the State. In the Los Angeles area taken alone, only 22% of all households could afford the median price, according to the Association. This was higher than the proportion in the San Francisco Bay area, where only 15% of households could qualify, but lower than the Orange County and San Diego areas (both at 29%) and much lower than the Riverside/San Bernardino area (46%). See Los Angeles Times, June 3, 1988, Part IV, p. 2.

²Indeed, taking a 15-year, Statewide perspective, the California Association of Realtors (CAR) points out that the median price of a single-family house in California rose by a multiple of about five during 1974-88, while the median price in the nation as a whole approximately tripled. Meanwhile, the median household income in California rose a bit less rapidly than the national

effects of the current "buyers' panic" for single-family homes will only exacerbate pressures on the rental housing market that have probably been building for some time.

Unsurprisingly, these pressures have made construction of new rental housing profitable, creating a major apartment boom in the City during the past five years. The specifics of the changes between 1984 and 1987 are discussed in Chapter 2. As indicated in Chart 1.1, by the end of 1987 we estimate that there were about 1,283,700 housing units in the City. Of this total some 478,700 units, or 37%, were stabilized rental units registered with the Rent Stabilization Division. Another 91,100 units, or 7% of the housing stock, were new multi-family units, built since October 1978 and therefore exempted from stabilization. In addition, there were 68,400 other multi-family units including luxury units and various types of subsidized housing initially exempted from rent stabilization at the time of the adoption of the RSO, together with units later removed from the stabilized

median. Thus, the Association argues, California households are losing the economic capacity to afford single-family houses noticeably faster than those in most of the rest of the country. See Housing the Future, Section 3.13, Home Ownership.

stock as a consequence of major rehabilitation.¹ Assuming that the proportion of rental housing units in the City has not changed dramatically since 1980, 60% of all the units in the City, or 766,488, were rented, and 478,700, or 62%, of these units were rent stabilized.

¹The RSO excludes 11 types of housing from rent stabilization, including units first occupied after October 1, 1978, non-profit stock cooperatives, subsidized housing specifically exempted from rent regulation by Federal or State law, and luxury units. See Section 151.02M of the RSO.

CHART 1.1

ESTIMATED COMPOSITION OF THE LOS ANGELES HOUSING STOCK: 1987

<u>Unit Type</u>	<u>No. of Units</u>	<u>Percent</u>
Stabilized Units	478,700	37%
New Multi-Family Units	91,000	7
Other Multi-Family Units	68,400	5
Single Family Homes	583,900	46
Condominiums	61,600	5
TOTAL	1,283,700	100%

SOURCE: The most recent actual count of residential units in the City is the Census Bureau's 1980 Census of Population and Housing. In order to estimate the 1987 total, we have adjusted the 1980 figure according to (i) building permits issued since for new housing; and (ii) demolition permits issued. (Approximately 4-6% of all building permits issued do not result in construction, while the overwhelming majority of demolition permits do lead to demolition. New units created by alterations or additions to existing structures are not counted, so that the total shown is probably slightly understated. Also, living units defined as "group quarters" by the Bureau of Census are excluded from its count of "housing units." These quarters include dormitories, barracks, and other forms of institutional housing, as well as two-thirds of the Single Room Occupancy units in such very low income areas as Skid Row.

The figures show that the market has responded to the demand for rental housing generated by rising incomes, new household formation and the rising cost of single-family housing by increasing the supply of rental housing. But the transition from a heavily single-family and owner-oriented City to a more multi-family and renter-oriented one has not gone entirely smoothly. In particular submarkets, rents have risen relentlessly. For example, rents for Single Room Occupancy (SRO) dwellings -- small, single furnished rooms with no private kitchens or bathrooms -- which house a portion of the City's very lowest income population, appear to have risen by 344% from 1970 to 1986. This increase far exceeds increases in income for this portion of the City's population, with the result that some people have become "homeless" (i.e., unable to find any longer-term accommodations that are affordable within their limited incomes).¹

Other people are reported to have doubled up or moved into unorthodox spaces such as garages to overcome the shortage of very low-rent housing. A Los Angeles Times survey in June, 1987 reported that as many as 42,000 families were living in garages in parts of the City and the County.² The problems of the City's

¹For an extensive description and analysis of this phenomenon and of the general problem of homelessness, see HR&A, The Fiscal and Economic Situation of Single Room Occupancy Housing in Los Angeles, op.cit., and also Hamilton, Rabinovitz and Alschuler, The Changing Face of Misery: The Skid Row Area in Transition, (prepared for the Community Redevelopment Agency: July 1987), especially Volume III, p. 26.

²"A Garage is Not a Home," Los Angeles Times, Nov. 28, 1987, and "Garages: Immigrants In, Cars Out", Los Angeles Times, May 24, 1987 by Stephanie Chavez and James Quinn.

low income renter population have been further exacerbated by the fact that a portion of the City's oldest and presumably cheapest rental housing is in unreinforced masonry or brick buildings that were damaged in recent earthquakes, or which need to be strengthened to prevent future seismic damage. About 45,000 rental units have been cited by the City's Department of Building and Safety as in need of seismic upgrading, and the costs of this upgrading must be passed along to tenants if not subsidized from public sources.¹

Meanwhile the pressure of all this growth and change on neighborhood fabrics has generated reactions from residents in the City's more traditional single-family, homeownership-oriented neighborhoods who wish to maintain the character of their local environments. Movements for restraints on further growth are growing in Los Angeles in ironic lockstep with the accumulation of evidence that further growth is an inevitable concomitant of the birth rate, even if the additional pressure created by migration is ignored. These pressures, too, are increasingly affecting both the rental housing market and the discourse on housing policy, of which the issue of rent stabilization is a part.

¹Housing the Future, op.cit. Section 3.8, "Seismic Rehabilitation".

Organization of the Report

This Report consists of seven Chapters. This Chapter has presented a general statement of the purpose and the context of the enterprise. Chapter 2 first traces changes in a series of specific factors that have helped to define the character of the housing market in the City since 1984. Among the factors that shape this market, interest rates and tax regulation are especially important, and they have been changing dramatically in recent years. The Chapter then discusses the behavior of three key variables -- vacancy rates, tenant mobility, and density of occupancy -- that are particularly important to the operation of the market, and which have also exhibited important changes since the last review of the rent stabilization system was conducted.

The last part of Chapter 2 addresses the difficult question of construction of new rental housing. Debates over the impact of rental regulation on new construction have been endemic to the field. This concluding section of Chapter 2 updates and extends the analysis of new construction that appeared in the initial review published in 1985. It shows how the change in the pattern of new construction is affected by the regulatory environment in which growth is managed, and in which the rent stabilization program also operates. A number of critical changes in regulations affecting new construction of housing have come about in Los Angeles since the initial review, and they are also briefly reviewed.

Chapter 3 focuses on the distribution of rent stabilization benefits among tenants. It reports the results of a large scale telephone survey of tenant households in the City that was conducted by the project team in the last months of 1987. The Chapter analyzes trends in rents and other changes in the housing situation of tenants since the 1984 data collected for the initial review of the system. It also estimates the money benefits to tenants generated by the existing rent stabilization system, as compared to the pre-1985 system which featured a flat limit, rather than a CPI-based limit, on rent increases. It also compares the situation of tenants in rent stabilized units to those in newer units that are not covered by the RSO.

Chapter 3 also analyzes the differential impact of the RSO on tenants in different locations within the City, an aspect which received little emphasis in the initial review. The major geographic subunits used in this analysis are the City's six Labor Market Planning Areas (LMPAs). The boundaries of the LMPAs roughly divide the City into a Southcentral area, a Valley area, the Westside, the Northeast, the Harbor and the Central or Hollywood-Wilshire area. Since the boundaries of these LMPAs are not widely known, Chart 1.2 is included at the end of this Chapter to show them superimposed on a map of the City.

Of course, these LMPAs are quite large, and in general do not express the boundaries of the smaller "communities" in which Los Angeles' citizens see themselves as residing. Thus, in addition to LMPAs, the Chapter also divides the City into 13 smaller "community" areas for survey and analytic purposes. These are aggregations of the 35 Community Planning Areas which are the geographic subdivisions specified in the City's General Plan. A map of the 13 community areas used herein, superimposed on a map of the City, is also included at the end of this Chapter as Chart 1.3. Although the numbers of respondents within each community area are necessarily very small, and observations about them are therefore quite speculative, some major differences among areas did appear and are reported.

Chapter 4 focuses on the owners of multi-family housing in the stabilized stock, analyzing their current income and expenses, and changes in their operating costs since the 1984 data collected for the initial review. The aforementioned special analysis of the role of liability insurance costs is also reported here.

Chapter 5 discusses building maintenance and reinvestment and apparent trends in either that may arguably be related to the rent stabilization regime.

Chapter 6 concentrates on the special situation of tenants and landlords in buildings dominated by units with so-called "historically low rents" that were described at the outset of this Chapter.

Chapter 7 presents the conclusions and policy implications of the review as seen from the perspective of the consultants. It is presented in response to the City's request for the consultants' views, and in the knowledge that policy implications are in substantial degree in the subjective eye of the beholder. It is entirely possible that others might draw different policy conclusions from the same data. Thus, the consultants' interpretations are provided as one and only one of the many perspectives that City officials will need to consider in their policy deliberations.

A separate volume of Technical Appendices provides methodological analysis and further detail on many findings. The reader with a technical interest in the analysis is urged to review the second volume as well.

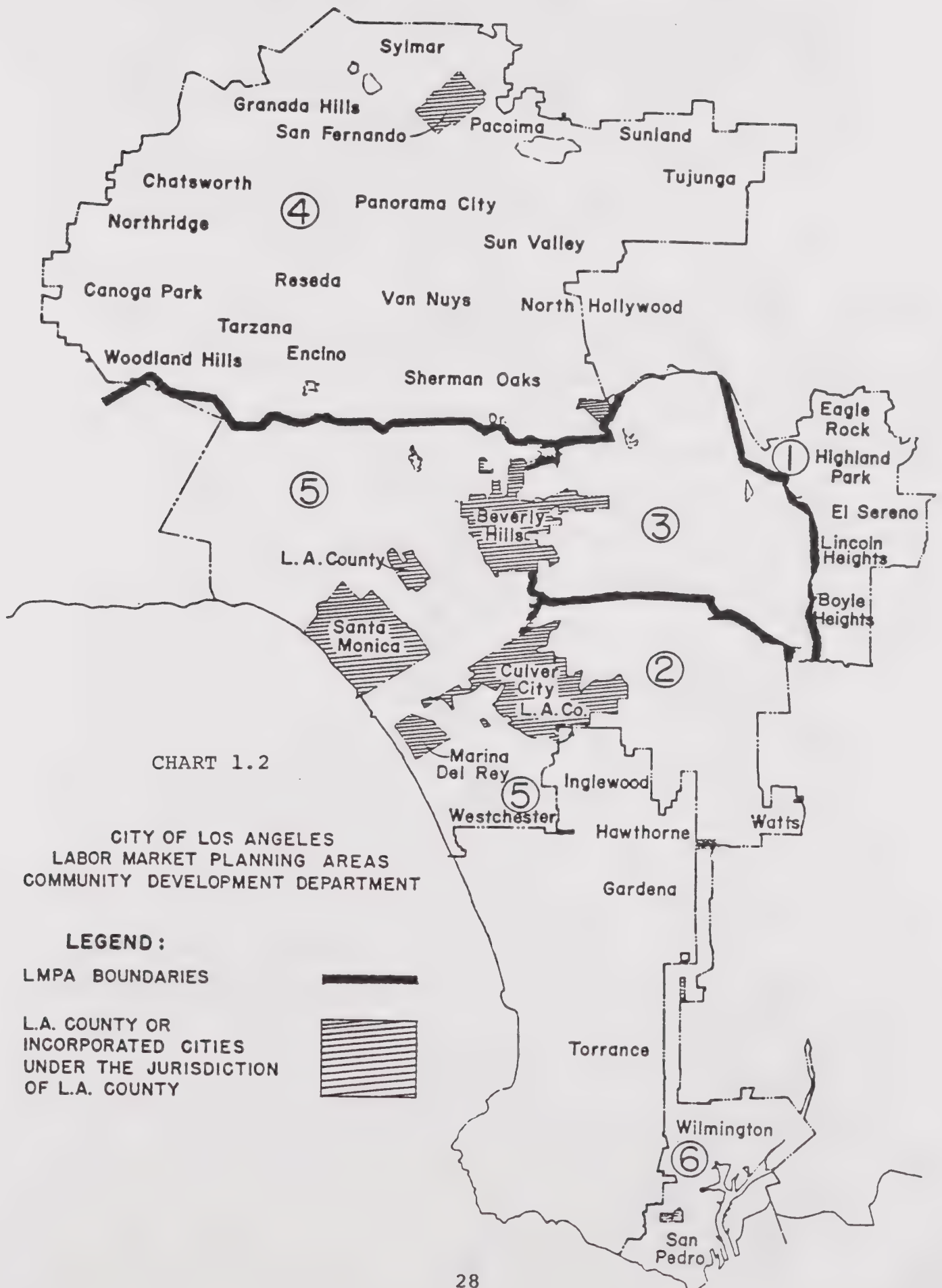


CHART 1.2

CITY OF LOS ANGELES
LABOR MARKET PLANNING AREAS
COMMUNITY DEVELOPMENT DEPARTMENT

LEGEND:

LMPA BOUNDARIES

L.A. COUNTY OR
INCORPORATED CITIES
UNDER THE JURISDICTION
OF L.A. COUNTY



CHART 1.3

**CITY OF LOS ANGELES
13 COMMUNITY AREAS**

CHAPTER 2

RECENT CHANGES IN HOUSING MARKET INDICATORS

Introduction

Housing markets respond to a diverse array of influences, among which rent stabilization may be more or less important. In order to assess the impact of rent stabilization, it is therefore desirable first to look at the market as a whole.

Seven aspects of the housing market, and their relationship to the City's rent stabilization system, are discussed in this Chapter. Five of these factors -- interest rates, tax rates, vacancy rates, tenant mobility and the rate of new construction of multi-family housing -- were discussed in the initial review of the system which was published in 1985, and the current situation is compared to the situation as described in that Report. The other two factors considered here have to do with changes in the national and local regulatory environment that have occurred since 1984 -- changes in the tax treatment of multi-family housing construction affected by the 1986 Federal Tax Reform Act, and changes in the local regulatory environment brought into being by a series of post-1984 court cases, citizen-sponsored initiatives and City Council actions.

Each of these indicators provides insight into an important aspect of the environment in which the rent stabilization program is operating today. Interest rates and tax rules, together with general economic conditions, provide the basic structure within which investors make decisions about new construction or the purchase, operation or rehabilitation of existing housing. Vacancy rates, tenant mobility, density of housing occupancy, rates of new construction, and changes in the local regulatory environment all describe the way in which the market and the local government respond to these influences to meet the needs of both owners and tenants. While no single variable can explain the behavior of something as complex as the housing market in its entirety, these factors together paint a reasonably comprehensive picture of the Los Angeles multi-family housing market since 1984, and permit qualitative assessment of the probable effects of the operation of rent stabilization in that market when the record from 1977 to 1987 is assessed overall.

Interest Rates

Of all the factors that influence local housing markets in the U.S., most analysts would agree that interest rates are the most powerful. Variations in interest rates affect both the supply and demand sides of housing markets. On the demand side, the rate of interest effectively sets the maximum prices that prospective buyers can pay for homes, since it establishes the

payment levels that they can afford for given mortgage terms. This in turn affects the rental market through the resulting choice of ownership or rental status. When interest rates fall sharply after a period of high levels, tenants who have been postponing home purchases tend to move out, thus softening the market for rentals. When interest rates rise, the opposite is likely to occur, since fewer households can afford to enter the ownership market. This latter effect, however, may be offset in periods of high inflation if interest rates lag behind changes in the price level, thereby making ownership an attractive hedge against inflation.

On the supply side, the effect of interest rates on rental housing is even more direct, since interest rates represent the cost of capital for new construction. High interest rates translate into higher costs per unit and therefore into higher rents for units of equivalent quality. In periods of high interest rates, therefore, the potential market for building new rental housing is likely to be restricted, although there may be more potential tenants among those who are no longer able to enter the market as owners. Thus, except when incomes and demand for housing are both rising sharply rental housing construction is very sensitive to interest rates.

Interest rates are established by national and international financial markets. There is relatively little, short of subsidy, that the City can do to affect these rates, although some meas-

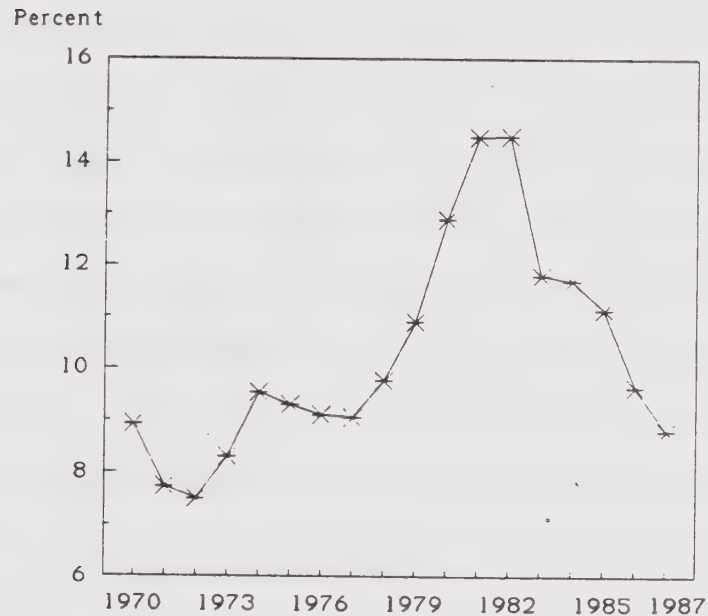
ures may be taken to reduce the impact of rate changes on specific groups. The general level of interest rates must thus be taken by localities as a given. Therefore, the Los Angeles housing market is to a substantial extent a captive of the consequences of national and international interest rate fluctuations.

The contrast in interest rates between the 1977-1984 period of rent stabilization and the 1984-1987 situation could not have been more dramatic, as shown in Chart 2.1.¹ From a level of about 9% in 1977, average interest rates on first mortgages rose with inflation in the early 1980s to a peak of over 14.5% in 1981 and 1982. The rates actually paid by developers of new rental housing may have been even higher in many instances. Not surprisingly, as was shown in the initial review of the RSO based on 1984 data, the level of new construction of rental housing plummeted. The first signs of a turnaround were just becoming visible when the 1985 Report was issued, as interest rates had begun to fall from their 1982 high to a still elevated but no longer stratospheric level of 11.7% by 1984.

¹See Technical Appendices for tabular data corresponding to Chart.

CHART 2.1

INTEREST RATES ON CONVENTIONAL FIRST MORTGAGE LOANS:
1970 - 1987



Source: The interest rate for 1987 is a simple average of monthly interest rate averages through November, 1987. Interest rates from 1970 to 1974 were obtained from Table 5.10 in California's Housing by I. Lowry et al. Interest rates from 1975 to November, 1987 were obtained from the Federal Home Loan Bank Board (FHLBB) publication, Savings & Loan Financing Source Book, and from telephone conversations with FHLBB staff.

Between 1984 and 1987 this decline continued. Rates fell from 11.7% in 1984 to 8.8% in 1987. As indicated in the last sections of this chapter, the recovery of the new construction

market since 1983-4 has been correspondingly remarkable; as interest rates declined new multi-family construction levels were achieved that had not been seen in decades.¹

There is little direct linkage between interest rates and rent stabilization. However, interest rates are all important in shaping the larger economic environment in which decisions on housing occupancy and investment are made. The strength of their impact is so great that it is difficult to isolate the impact of such other measures as rent stabilization. Therefore, it is critical to be aware of the constant and powerful effect exerted on the market by interest rates as one attempts to sort out the lesser effects of local regulatory policy.

Tax Rates

Almost equally important is the impact of tax considerations on rental housing construction. Tax rules have always been significant for rental housing because Congress has chosen to execute Federal housing policy largely through tax measures. The largest such impact is the homeowner mortgage interest deduction, which affects the relative cost and attractiveness of home ownership. Not far behind are the incentives or disincentives provided for multi-family rental housing construction through interest deduction and depreciation provisions in the Internal Revenue Code. When these provisions change, the effects on cost and

¹New construction is discussed later in this chapter.

production of rental housing may be dramatic. And as with interest rates, such changes are made at the national, and to a lesser extent, the State levels. The City is largely powerless to influence such changes, even though their effects may be great.

Major changes in tax law have occurred since 1985. As with interest rates, the discontinuity between the two periods could hardly be more pronounced. During the first period of rent stabilization (1979-83) which was examined in the 1985 Report, a series of changes in Federal tax provisions enhanced the profitability of rental housing construction and ownership. After 1984, another series of changes was made which had the effect of eliminating these gains. While a full description and analysis of the effects of these tax changes on rental housing construction is beyond the scope of this Report, highlights of the key changes are summarized here because the Los Angeles housing market's performance cannot be understood without recognition of these macro-level shifts.

As indicated in the 1985 Report, the Economic Recovery and Tax Act of 1981 was intended to stimulate an economy then in serious recession. It therefore provided powerful incentives to investment of all kinds. From the perspective of rental housing, two provisions were critical. The presumed useful life of a building was reduced drastically to 15 years from its prior level of 40 years. This meant that the capital cost of a rental building could be written off against income much more rapidly, which

reduced the volume of taxable income derived from the property. At the same time, the provision for accelerated depreciation was also relaxed. The Accelerated Cost Recovery System (ACRS) that was enacted allowed an owner to write off a building in about nine years. While the general reduction in tax rates in the 1981 Act favored all types of business, these provisions made real estate an especially attractive investment. Consequently, capital flowed into the industry in large amounts, notably through syndicated limited partnerships. There can be little doubt that the rapid growth of apartment construction which occurred in Los Angeles beginning in 1983 was stimulated in important part by this 1981 Federal enactment, which effectively reduced the cost of capital.

From 1981 to 1986, while Congress continued to amend the 1981 Act in certain respects, the rules remained essentially unchanged. Then, in 1986 the Congress passed a new Tax Reform Act that turned Federal policies dramatically in the opposite direction.¹ Its intent was to ensure that all types of income and investment would be treated equally by the tax law, based on a belief that such tax neutrality would improve the overall efficiency of the economy. For sectors like real estate that had previously been favored, this has meant a quite painful adjustment. For example the presumed useful life of residential prop-

¹H.R. 3838; P.L. 99-514, 1986.

erty was increased from 19 to 27.5 years.¹ While residential property retains a slight edge over commercial property, whose useful life was set at 31.5 years, the return to a longer depreciation period had dramatic consequences on the financial attractiveness of investments in residential property. Perhaps more importantly, the 1986 Tax Reform Act eliminated the accelerated depreciation provisions, so that far more income derived from a residential project is now taxable than was previously the case. In addition, a new set of passive loss limitations restricted the attractiveness of real estate investments by limited partnerships, which had become the dominant vehicle for mobilizing capital for the residential rental housing industry.

Despite the offsetting effects of reductions in tax rates, these provisions mean that housing construction has become a much less attractive investment today in relative terms. In other words, in 1987, when the Act was first implemented, a higher rate of projected cash return became necessary to attract investors into the multi-family residential investment field. Many projects that had been developed during the early 1980s were probably profitable at lower occupancy rates or at lower rents than is true today. Thus, the 1986 Tax Act was widely expected to create upward pressure on rents. However, if the lower interest rates noted in the first section simultaneously encouraged some households to move out of rental status into home ownership, the

¹Between 1981 and 1986 it had been increased from 15 years to 19 years.

rental housing market might not support substantial rent increases. In this event, the rate of construction of new rental housing would be expected to fall. As indicated in the closing sections of this Chapter, there is already evidence that this has in fact begun to happen.

This cycle is all too familiar to the housing industry. Overbuilding frequently leads to high vacancy rates, which then depress production, resulting, in growing areas, in both a short term shortage of housing and large rent increases. In the post-1984 period, however, this typical building cycle was strongly reinforced by the changes brought about by the 1986 Tax Reform Act.

To add to the potential seriousness of the problem, one tool which cities have historically had to respond to housing cost increases and shortages was also taken away by the 1986 Tax Act. This was the right to issue tax-exempt mortgage revenue bonds for multi-family housing, which are scheduled to be phased out under the 1986 Act. To the extent that this type of bond financing formed a cushion during past periods of high interest rates or capital shortages, as was the case in the 1977 - 1983 period, it has helped to smooth out fluctuations in the housing market. It appears that this option will not be available in the future.

The one counterbalancing feature of the 1986 Tax Act with respect to housing had to do with low income housing. Since affordable housing projects for low and moderate income tenants have generally been viewed by the real estate industry as uneconomic investments, the loss of incentives for investing in multifamily rental housing might have eliminated all private sector development of such affordable housing after 1986. Recognizing this, Congress provided for Low Income Housing Tax Credits which encourage investments in low income housing projects to generate tax savings for project investors.¹

However, due to restrictions in the Act, the value of these credits is much greater for corporations than it is for individuals.² And, even this attraction is limited to corporations whose

¹The Act allows a tax credit for housing projects placed in service during 1987, that is equal to 9% of the cost of constructing or rehabilitating qualified affordable housing units, and to 4% of the cost, less land, of acquiring qualified housing units. These credits can be applied directly to reduce Federal taxes each year for ten years. For projects put into service after 1987, the Treasury Department will adjust the credit percentages based on current interest rates. The Act includes definitions for qualifying projects, qualifying units and gross rent for qualifying units. The basic provision is that projects must include either a minimum of 20% of units affordable to households earning no more than 50% of the County median income, or a minimum of 40% of units affordable to households earning less than 60% of median income. SROs are eligible for the credit if they are occupied by the same tenant for at least six months. The Act limits the annual amount of credits usable in any state to \$1.25 per capita, which means that in California the maximum credits which may be taken total \$29,584,878. In the future, the State's Mortgage Bond Allocation Committee will be responsible for allocating credits to projects.

²Individuals may shelter no more than \$25,000 of income with the credit. Given a 28% maximum individual tax, this means that no one person can take more than \$7,000 worth of credits per year. At that rate, a separate investor must be found for each unit of affordable housing built, creating a cumbersome and costly in-

unsheltered tax liability is greater than 20% of earnings.³ A further depressant on the use of this tax credit system is that projects based on credits do not work without public subsidy or philanthropic support. The tax credit will probably generate investment equal to 10-35% of total development costs. Because any project built with the credit is restricted in the rent it can charge, such projects will not generate revenues adequate to support a mortgage large enough to cover the balance of development costs. Most observers think that, depending on the percentage of low income units and on interest rates, the mortgage in tax credit projects will cover half of development costs at most. If low cost housing projects are to be built, therefore, the gap will have to be made up by public or philanthropic agencies. Thus, even if corporations in Los Angeles were to find the Low Income Housing Credit attractive, the actual housing production that it would stimulate would depend on the availability of public subsidies, which are currently in short supply.

vestment structure. In addition, tax credit benefits are phased out for persons earning between \$200,000 and \$250,000, and they are eliminated entirely for those with incomes exceeding \$250,000.

³The Act restricts the use of the credit for corporate investors though its interaction with the Alternative Minimum Tax, which requires all corporations to pay a minimum tax of 20% on profits, regardless of credits or deductions. The principal means by which low income housing developments are likely to use the credit is through syndications in which corporations invest as limited partners, either in projects or more likely in blind pool syndications where money is pooled and applied to different projects without the specific attribution of projects, to limited partners.

In sum, it is clear that the Los Angeles housing market has been powerfully affected by tax law changes since 1984, and that this effect is likely to continue, perhaps with quite negative implications. As with interest rates, it is not possible to isolate the effects of these factors from those of rent stabilization. Nonetheless it seems likely that in the post-1984 period, it has been the massive change in the patterns of interest rates and Federal tax policies, together with the relentless increase in demand described in the first Chapter resulting from a combination of growth and the rising price of single family housing, which have been the prime forces that have shaped the rental housing market in the City.

Vacancy Rates

Vacancy rates are a key indicator of the performance of a rental housing market. Defined as the percentage of total units in the market that are available for rent at a given time, the vacancy rate is the most widely utilized measure of pressure in a given market. Conventionally, a well-functioning market is assumed to require a vacancy rate of 5 to 6% in order to ensure that people who want to move have some choice, that new entrants to the market have access to housing, and that competition for tenants among owners provides incentives for adequate mainte-

nance.¹ However, relatively few large cities have realized this level in recent years, and vacancy rates in housing accessible to low and moderate income households have tended to be much lower.

Rent stabilization ordinances have often been related to vacancy rates in two ways. First, exceptionally low vacancy rates and associated pressure on rents have often been precipitating factors in the political process leading to the adoption of rent regulation. Second, some ordinances explicitly include a target vacancy rate beyond which level rent regulation no longer takes effect.² In the present instance, however, the purpose of examining rental housing vacancy rates is to identify the impact of the Los Angeles Rent Stabilization Ordinance, which has no such vacancy rate cutoff, on the local housing market.

Measurement of rental housing vacancy rates is difficult. Most cities believe that direct surveys are too costly to conduct on a regular basis, and indirect methods are often inconsistent in their ways of recording a vacancy. The latter was the case at the time of the 1985 study. It was necessary at that time to compare data from the U.S. Census Bureau, the Southern California Gas Company, the Federal Home Loan Bank Board of San Francisco

¹See James W. Hughes and George Sternlieb, The Dynamics of America's Housing. New Brunswick, N.J.: The Center for Urban Policy Research, 1987, pp. 187-193 for a discussion of recent trends in vacancies and their market significance.

²New York City's Ordinance is the most famous example of this. The 6% vacancy rate cutoff provision in that Ordinance requires the City to commission a highly detailed Housing and Vacancy Survey every three years.

and the Institute of Real Estate Management (IREM) in order to calculate vacancy rates and cross-check them with data from the Los Angeles Department of Water and Power (DWP). This comparison established that the DWP vacancy data were superior to those from the other five sources that were available on an annual basis.¹ Although the multi-family stock does not correspond exactly to rent stabilized housing, it approximates it closely enough that measuring vacancies by idle meter counts does provide a reasonably accurate estimate of the relative shifts in pressure on rental housing over time. For the present analysis, therefore, DWP vacancy data are used exclusively.

Chart 2.2 shows the changes in vacancy levels and rates in Los Angeles in 1977 through 1987, as reported by DWP.² (The vacancy rates shown in Chart 2.2 are annual averages computed from monthly data reported by DWP.) Through this, the full period of rent stabilization in Los Angeles, vacancy rates have changed somewhat in response to changes in demand by new households and to shifts in supply, as new housing units have been built and old ones removed from the stock. What is most striking about these data, however, is the indication that, through a time of severe recession followed by recovery, with interest rates fluctuating up to unprecedented levels and then back down again, vacancy rates have always either been stable or increased.

¹See 1984 Rental Housing Study: Housing Performance and Production Under Rent Stabilization, pp. 20-35.

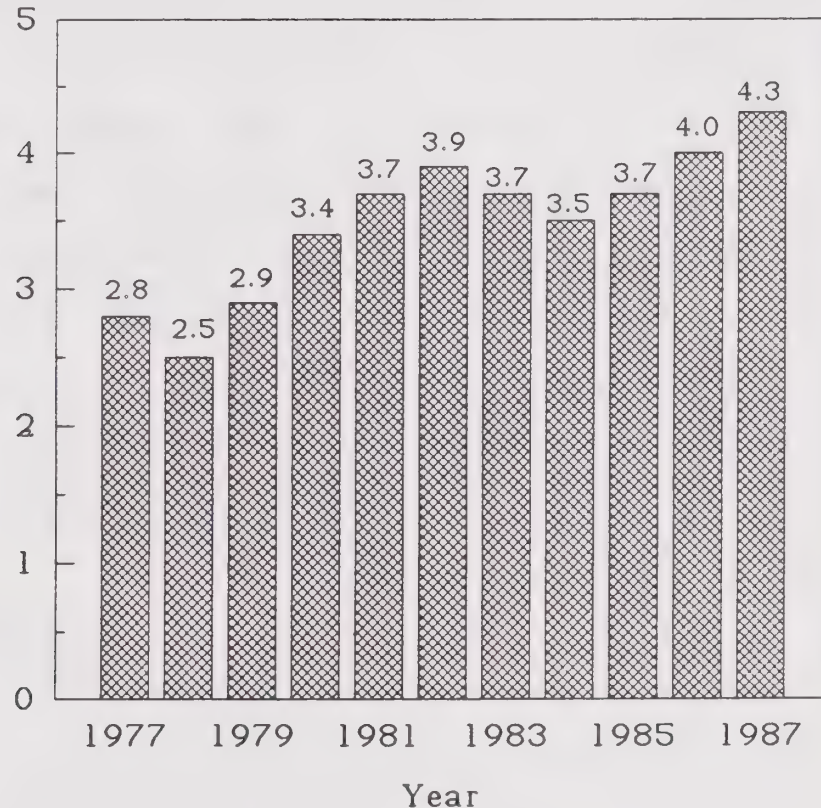
²See Technical Appendices for tabular data corresponding to Chart.

The Chart shows that in 1978 when the RSO went into effect, the vacancy rate was at its all time low for the entire period of 2.5%. The rate then rose in succeeding years to a high of 3.9% in 1982. This was not entirely unexpected, since that was a recessionary period also characterized by high inflation. Because of unemployment and falling real incomes, housing demand was reduced. Less expected, however, was the fact that, after declining slightly during the early part of the subsequent economic recovery to the 3.5% reported in the earlier study, the vacancy rate has subsequently risen again to 3.7% in 1985, 4.0% in 1986 and 4.3% in 1987.

CHART 2.2

AVERAGE ANNUAL VACANCY RATES, MULTI-FAMILY UNITS
LOS ANGELES, 1977-87

Vacancy Rate



SOURCE: Vacancy rates are estimated from idle DWP meter counts. Master-metered buildings are therefore excluded from the vacancy rate calculations. The vacancy rates shown in this chart differ slightly from those displayed in the 1984 Rental Housing Study: Housing Production and Performance Under Rent Stabilization, Exhibit 2.3. The vacancy rates in this study are based on annual averages, while the rates contained in the 1985 study are based on vacancies reported in the month of April.

Thus, predictions that rent stabilization would result in very low vacancy rates have not been borne out. This has been in large part due to high levels of new construction of rental housing in recent years. This is not to say that the Los Angeles rental housing market is functioning well for all households. The vacancy rates reported here are overall averages which do not differentiate between levels of income or rent. For low and moderate income households, reports of extremely low vacancy rates are commonplace, and the problem of homelessness is demonstrably severe. Nonetheless, generalized compression of vacancy rates cannot be fairly associated with rent stabilization in Los Angeles, since, over the period of its operation, overall vacancy rates have risen rather than fallen.

Tenant Mobility

The ability of households to move when and where they wish, within reasonable constraints of income, is another important indicator of the functioning of a housing market. However, mobility is not necessarily always a benefit. If households are forced to move by rapidly changing rent levels or other shifts in their economic situations, then rising mobility may suggest the existence of a problem. To understand mobility shifts, it is therefore necessary to examine the patterns of household movement over time.

During the initial period of rent stabilization, 1977-84, mobility in Los Angeles decreased substantially. The earlier study reported that in 1984 approximately 45% of Los Angeles households in rent stabilized units had moved within the previous two years, compared to 67% in 1977 prior to the advent of stabilization. This 33% decrease indicated a marked decline in tenant mobility. While the 1984 Los Angeles rate was still much higher than the average for other cities in the nation, Los Angeles appeared to be tending toward the national norm, which was also a major decline in mobility.

Not all of the Los Angeles change could be attributed to rent stabilization, since similar shifts appeared to be occurring in the cities in the surrounding area without rent stabilization that were analyzed for comparison in the 1985 study. The Cities of Inglewood, Torrance, Glendale, Pasadena, and Burbank were then experiencing an 18% reduction in mobility. Thus, while the decline was greater in Los Angeles, the difference between it and the comparison cities was not large.

The results of the present study show that the mobility decline in Los Angeles reversed itself between 1984 and 1987. Los Angeles households in the rent stabilized stock appear to have become much more mobile once again. Chart 2.3 shows the average length of tenure of residents of rent stabilized housing units in the City, together with the respective distributions of households in terms of the average number of years that they have

lived in their current units. Both of these are indicators of the propensity of people to move. In 1984, the average tenant in the City had lived at his or her current residence for 5.5 years, a significant increase from the 3.6-year average of 1977. In the last three years, this pattern has reversed and the average length of tenure of tenants in rent stabilized units has fallen quite sharply, from 5.5 to 4.8 years.

CHART 2.3

TRENDS IN TENANT MOBILITY: LENGTH OF TENURE OF HOUSEHOLDS IN RENT STABILIZED HOUSING, LOS ANGELES, 1977, 1984, AND 1987

<u>Length of Tenure</u>	<u>Percent of Tenants:</u>		
	<u>1977</u>	<u>1984</u>	<u>1987</u>
Less than 1 year	31.2	21.4	25.8
1 to 2 years	35.6	23.5	29.4
3 to 5 years	15.6	21.0	17.6
6 to 8 years	17.7	14.2	10.0
Over 9 years	N/A	19.9	17.2
<u>Average Number of Years:</u>			
	3.6	5.5	4.8

Some indication of how this occurred is provided by data on the changes in the proportions of tenants with different lengths of residence. Tenants who had lived in their current housing for less than three years accounted for over 55% of the total in 1987, up from 45% in 1984. On the other hand, tenants with

tenure of three to eight years fell to 28% of the total, down from 35% in 1984. The remaining group, those tenants with more than nine years of tenure, fell from about 20% to just over 17% of the total. Since these long-tenured households are generally also the oldest tenants, we would expect a low rate of turnover. Unfortunately, the available data do not permit a comparison between the change in this group since 1984 and the change from 1977 to 1984. Nonetheless, the rapid rise in the proportion of tenants with six or more years of tenure from the level in 1977 almost certainly included an increase in the proportion of very long term tenants. Yet, even that group now seems to be accounting for a smaller percentage of the total.

How these changes have manifested themselves according to income, race, household size, and age of household head is shown by Chart 2.4, which displays the average length of tenure for each subgroup and the total in 1977, 1984, and 1987. In almost every category, average length of tenure declined between 1984 and 1987. Especially sharp decreases are visible among lower income households, among White and Hispanic households, among two-person and larger households, and among youthful households. This suggests that the change may be accounted for in part by the arrival of immigrants who are finding housing in the rent stabilized stock. The fact that they have been able to do so during a period in which the overall vacancy rate has been rising is probably explained by the high level of new construction that has offered more attractive housing to people who can afford to leave

their former units and upgrade their housing. This hypothesis is supported by the rising average density in rent stabilized housing which is discussed below.

CHART 2.4

AVERAGE LENGTH OF TENURE OF HOUSEHOLDS IN RENT STABILIZED HOUSING, BY INCOME, RACE, HOUSEHOLD SIZE, AND AGE OF HOUSEHOLD HEAD, LOS ANGELES, 1977, 1984, AND 1987

<u>Household Category</u>	<u>Average Length of Tenure (Years)</u>		
	<u>1977</u>	<u>1984</u>	<u>1987</u>
<u>Annual Income</u>			
Under \$10,000	3.8	6.2	5.4
10 - 20,000	3.3	5.6	4.6
20 - 30,000	3.5	4.6	4.8
30 - 40,000	3.7	5.1	4.6
Over 40,000	2.2	4.7	4.2
<u>Race/Ethnicity</u>			
White	4.0	5.9	5.0
Black	3.3	5.4	5.5
Hispanic	2.7	5.1	3.9
Other	2.6	3.8	3.6
<u>Household Size</u>			
One person	4.2	6.5	6.4
Two persons	3.2	5.3	4.0
3 - 4 persons	2.7	4.3	3.9
Over 5 persons	2.8	5.6	4.1
<u>Age of Household Head</u>			
Under 30 years	1.4	2.5	1.9
31 - 61 years	3.4	5.2	4.8
Over 62 years	7.7	10.4	11.1
<u>All Tenants</u>	3.6	5.5	4.8

Only three subgroups appear to run counter to the trend toward increased mobility. Households with incomes between \$20,000 and \$30,000 showed slightly greater average length of tenure. Similarly, Black households were the only ethnic subgroup that exhibited basic stability in tenure over the period. In fact, the only subgroup that continued to show a significantly increasing length of tenure were those households headed by persons over 62 years of age. This is the only group with an average length of tenure that exceeded the life of rent stabilization, indicating that disproportionate numbers of the elderly tended to occupy housing that had never been vacancy decontrolled. Thus, older tenants were most likely to be receiving significant benefits from long-term occupancy, and would be expected to be least likely to move.

Despite the apparent increase in mobility, it should also be carefully noted that the average length of tenure shown in Chart 2.3 for 1987 nowhere approached the levels recorded in 1977. In other words, although tenants have moved more frequently in the past three years than in the years immediately preceding, they have still, on the average, occupied their housing for a year longer than was the case in 1977. Furthermore, these data do not explain why either the former decline in mobility or the subsequent reversal has taken place. We know that during the 1977-1984 period, mobility declined both in Los Angeles and in comparable cities without rent regulation. We have suggested above that the more recent experience may be attributed to the combina-

tion of continuing in-migration of lower income households and the supply of newly constructed units that are competitive with vacancy decontrolled rent stabilized housing. However, it is impossible to be certain about the identity of the major influences on tenant mobility or about the balance of potency among these causes.

The role of rent stabilization in this process might best be described as contextual. By maintaining rents at levels comparable to general inflation, the RSO probably allows tenants in submarkets that have experienced demand pressure and rapidly rising rents (e.g., Westwood) to continue to occupy housing that might otherwise be too costly. For these tenants, the level of housing choice may have been reduced, but the opportunity to stay in their housing and neighborhoods has been maintained. At the same time, the vacancy decontrol element of rent stabilization, combined with the exemption of new construction from regulation, may have encouraged construction of new rental housing. By providing some level of competition between vacancy decontrolled housing and newly constructed stock, the RSO may be ensuring that the market is substantially competitive and that for the most part people with rising incomes can move to better housing if they wish to, rather than continuing to occupy less desirable rent stabilized housing even if the latter is a bargain as compared with free-market rents. At this point in the history of rent stabilization, less than 20% of the stock has never been

subject to vacancy decontrol, so it is perhaps not surprising that mobility patterns show signs of returning toward pre-stabilization levels.¹

Density of Housing Occupancy

The density of occupancy of housing has long been another important indicator of the functioning of housing markets. Although standards change over time and differ from place to place, the idea that adequate space is critical to housing satisfaction is widely recognized in housing policy.² Generally, density of occupancy is recognized as reflecting many influences, including tenant income, housing supply and price, demographic and household structure, and social and cultural patterns of preference for space. Rent regulation may affect density in several ways, notably through its impact on supply availability. It has often been asserted that some small households may over-consume space in order to hold on to lower rent housing, while larger families may be unable to find suitably sized units and therefore are subject to crowding.

Density in housing is usually measured by the number of persons per room. This, in itself, is a neutral indicator. Overcrowding, on the other hand, can only be defined in relation to a standard reflecting personal or community values concerning

¹See Chart 2.2.

²See Hughes and Sternlieb, op. cit., pp. 194-196.

what constitutes an appropriate minimum level of per-person consumption of housing space. In the U.S. in recent years, the standard of one person per room has been generally accepted.¹

By this standard, there can be no question that crowding in Los Angeles, which was increasing at the time of the 1985 study, has continued to increase in the past three years. Chart 2.4 provides a summary picture of changes in population density in rent stabilized housing since the inception of rent stabilization. The average number of persons per room in the rent stabilized stock rose from 0.67 in 1977 to 0.80 in 1984, and continued to climb to 0.90 in 1987.² This a 34% increase in ten years. As a result, over one-fifth of households in the City may now be defined as overcrowded. Households with an average occupancy of more than one person per room have continued to grow as a proportion of the total, from 9% in 1977, to 16% in 1984, and to 21% in 1987.³ The earlier review of RSO impact concluded that the data left little question that Los Angeles residents were steadily raising the ratio between the number of household members and the number of rooms occupied by the household. Data reflecting the three-year time span since has clearly reaffirmed that conclusion.

¹Hughes and Sternlieb note that the criterion for acceptable per-person space has grown more stringent (from 1.5 persons per room in the 1950s to 1.0 person per room today) even as the incidence of crowding has fallen dramatically in the U.S.

²See Chart 2.8, HR&A, The Rent Stabilization System for 1977 and 1984 statistics.

³Ibid.

CHART 2.5

DENSITY AND CROWDING IN RENT STABILIZED HOUSING, LOS ANGELES, 1977, 1984, AND 1987

Density Indicator	Year: <u>1977</u>	<u>1984</u>	<u>1987</u>
Average Persons Per Room	0.68	0.80	0.90
Percent of Households Crowded*	9.3%	15.8%	21.0%

* Defined as exceeding the level of one person per room.

Why this increase in housing density continues to occur is not obvious. The 1985 study, which included comparative data for a sample of non-rent stabilized cities, showed equal or greater increases in density and crowding between 1977 and 1984 in the surrounding cities. At that time about 7% of renters in the surrounding cities reported that their households contained more than one person per room in the unit where they lived; by 1984 the proportion had risen to 17%. It was therefore concluded that rent stabilization probably played little or no role in the density increase. For 1987, comparative data have not been collected from other cities, but we have no reason to think that the situation has changed. What has been changing over the ten-year span since the inception of rent stabilization is the demographic, ethnic, and income structure of Los Angeles residents.

The most obvious explanation for the observed increase in density is the influx of immigrant households that may be larger, on average than the average household found in the existing population. If this were the case, it might be argued that these households are usually also poorer than the existing average. Seeking housing in a stock that is not well adapted to their needs, they may find themselves in smaller units than their household sizes warrant. It is difficult to test this assertion with the available data. As shown in Chart 2.6 below, the average household size in the rent stabilized stock did not change appreciably between 1984 and 1987, but the absence of change in the aggregate average may mask opposing tendencies toward larger families in the immigrant population and smaller households in the rest of the population.

It is possible to examine density trends further by considering shifts within specific groups. Chart 2.6 also shows the values reported in 1984 and in 1987 for density, measured by average persons per room, and overcrowding, measured by the percentage of households with average density greater than one person per room.

CHART 2.6
DENSITY AND CROWDING, BY HOUSEHOLD SIZE,
LOS ANGELES, 1984 AND 1987

Household Size (Persons)	<u>Average Persons/Room</u>		<u>Percent Crowded</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
One	0.43	0.43	0.0%	0.0%
Two	0.67	0.74	5.2	9.2
3-4	1.19	1.15	30.0	29.7
5 or more	1.74	1.89	82.5	83.0

SOURCES: Los Angeles rental housing surveys, 1984 and 1987.

The Chart confirms that average density has increased a bit in large households in the stabilized stock, although there has been no measurable increase in the percentage of such households that are defined as overcrowded. About 30% of three or four person households were overcrowded in 1984, and about 83% of households with five persons or more fell into this category at that time. The percentages are about the same in both groups in 1987.

However, the Chart suggests there has been a noticeable increase in average density and a sharper rise in overcrowding among two person households. The percentage of such households considered overcrowded by this standard has been rising rapidly, from 5.2% in 1984 to 9.2% in 1987. A difference of this magni-

tude is unlikely to result simply from sampling variations. Rather, the results suggest that doubling up has occurred in single-room units even as overall average vacancy rates have risen. The most likely cause for such a tendency would be the faster rate of growth of rents for studio apartments than of income of one and two-person households, even though these single-room units rents are stabilized.¹

The relationship of income to density is shown in Chart 2.7. The Chart is not adjusted for price inflation, but the level of inflation was moderate in these years. The Chart indicates that since 1984 density has increased in every tenant income category except the highest and the lowest. The greatest growth in crowding occurred among households with incomes between \$10,000 and \$20,000, but substantial growth also characterized the income categories immediately above this one. In this group, the proportion of households in crowded circumstances increased from 16% to 23% in three years. These are the moderate income households among which the larger and younger families might be expected to occur. The data suggest that some portion of these households may be adding persons but not adding rooms.

¹This studio apartment stock of one-room units should not be confused with the one-room units available in SRO hotels, most of which are concentrated in the Downtown area known as Skid Row. The data presented here were collected in a telephone survey described in the next Chapter. Thus, the responding tenants all had telephones, which is very largely not true for SRO hotel rooms. Thus, these density and overcrowding figures refer to two-person households living in one-room accommodations other than SRO hotels.

CHART 2.7
DENSITY AND CROWDING, BY INCOME CATEGORY
LOS ANGELES, 1984 AND 1987

Income Category	<u>Average Persons/Room</u>		<u>Percent Crowded</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
Under \$10,000	0.94	0.95	20.9%	16.1%
\$10-20,000	0.80	0.97	15.9	22.6
\$20-30,000	0.73	0.76	12.9	15.3
\$30-40,000	0.62	0.70	6.0	10.6
\$40,000 and over	0.67	0.63	8.3	5.0

SOURCES: Los Angeles rental housing surveys, 1984 and 1987.

Density and overcrowding also vary substantially with tenant race and ethnicity, as shown in Chart 2.8. Differences in density among groups are striking. Hispanic households, with their larger sizes, are much more likely to be overcrowded. The 1987 survey indicated that half of the Hispanic households were living in overcrowded circumstances, as compared with 23% of the second most crowded group, the largely Asian population that categorized by the Census as in the "Other" non-White category. In fact, Hispanics constituted almost three-quarters of all overcrowded households in the rent stabilized stock in 1987, and Hispanics were the only racial/ethnic group which registered a higher percentage of overcrowded households in 1987 than in 1984.

CHART 2.8
DENSITY AND CROWDING, BY ETHNIC GROUP
LOS ANGELES, 1984 AND 1987

<u>Ethnic Group</u>	<u>Average Persons/Room</u>		<u>Percent Crowded</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
White	0.60	0.62	5.5%	4.7%
Black	0.76	0.75	13.5	8.3
Hispanic	1.36	1.38	44.2	49.7
Other	0.96	0.95	25.0	23.3

SOURCES: Los Angeles rental housing surveys, 1984 and 1987.

The Chart shows that the rates of change in density for all ethnic or racial groups between 1984 and 1987 were quite modest. As to the incidence of overcrowding, however, the aforementioned increase among Hispanics occurred at the same time as the overcrowding among Black households showed a rather surprising decrease. The overall Citywide rates masked both the increased crowding among Hispanic households and the decrease among Black households.

Finally, Chart 2.9 below shows the relationship of density to length of tenure for households in the rent stabilized stock. Increases in density are visible in every tenure category, and are particularly apparent among households with short tenure. About 15% of those with less than one year of tenure in their stabilized units were overcrowded in 1984, compared to almost 22%

in 1987. This suggests that households that have recently entered the market have both been larger and faced higher rents than was true in 1984. The apparent result has been higher density as a means of coping with these financial pressures.

CHART 2.9

DENSITY AND CROWDING, BY LENGTH OF TENURE

<u>Length of Tenure (Years)</u>	<u>Average Density/Room</u>		<u>Percent Crowded</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
Under 1 year	0.82	0.93	14.7%	21.6%
1 - 2 years	0.87	0.98	17.4	23.1
3 - 5 years	0.80	0.92	18.5	23.9
Over 6 years	0.70	0.69	12.3	13.3
<u>Additional Detail Collected Only in 1987</u>				
6 - 9 years		0.75		17.1
Over 9 years		0.66		11.4

SOURCES: Los Angeles rental housing surveys, 1984 and 1987.

Some of the trends between 1984 and 1987, particularly for intergroup comparisons, may be the result of differences in sampling strategy between the two studies, but we are confident that most represent real changes that have occurred in the rent stabilized housing market. In the longer term, the implications of this steady increase in densities may be quite serious. They imply more physical demands on this aging housing stock, and potentially higher levels of maintenance and repair expenditures if this stock is to be conserved as it ages further.

New Construction of Multi-family Housing

The impact of rent regulation on the construction of new private rental housing has been hotly debated for many years. Many economists and housing developers have argued that the existence of rent regulation deters investors from developing new rental housing even where such development is exempt from rent control, as is the case in Los Angeles, because it raises the level of risk and uncertainty.¹ Supporters of rental regulation tend to argue that this danger is overemphasized. They see housing investment decisions as being driven by other considerations, especially shifts in expectations about future demand and changes in interest rates and other elements of housing cost.²

In the 1985 study an explicit effort was made to test the impacts of rent stabilization on production of new rental housing. The conclusion of that analysis was that if rent stabilization had affected production of new rental housing, most of the impact probably occurred in the first year or two of the Ordinance's existence. As the nature of the Ordinance became clear, and developers saw that it was not arbitrarily or frequently changed, the market adjusted accordingly.

¹For example, see Peter D. Salins, The Ecology of Housing Destruction, New York: New York University Press, 1980.

²A recent example is John L. Gilderboom and Richard P. Applebaum, Rethinking Rental Housing, Temple University Press, 1988.

In the following discussion the level of new multi-family housing construction in Los Angeles during the 1978-1984 rent stabilization period is compared to that in the 1985-1987 period both for the City and also for the six comparison cities -- Pasadena, Inglewood, Glendale, Long Beach, Burbank and Torrance -- that were used in the 1985 study. Data are also provided for Los Angeles County as a whole. The analysis is designed to explore whether any evidence in the years since 1984 suggests a conclusion different from the earlier one as to the impact of rent stabilization, and to attempt to explain the pattern of new construction that has occurred.

Note that in Chapter 3, this report also takes up an important issue that was not addressed in the 1985 study, namely the rents that are being asked in newly constructed, unstabilized rental housing, compared to those in the stabilized stock. Of course, the rents for newly constructed units would be expected to be higher than average units in the older housing stock. Nonetheless, it is important to see whether their rate of increase over time has exceeded that in rent stabilized housing, since it is through access to newer units by tenants who can afford them that older housing becomes available to the population at large.

In order to estimate the level of new rental housing construction in Los Angeles and the surrounding areas, some data assembly compromises are necessary. Cities do not record rental

housing construction as such. Rather, they record the issuance of permits and certificates of occupancy for various types of residential construction -- single family, multi-family, and condominium. In this Report, we will follow standard practice and regard "multi-family" housing as essentially identical with "rental" housing. Condominiums include both ownership and rental units, but their numbers have fallen to an insignificant level after the boom of the early 1980's. The data reported below are based on permits for construction issued in each year. Although a small proportion of permits are not ultimately used, the information about them is more consistent than any other and it reflects the investment climate at the time of issuance. Permit data are, therefore, used in virtually all analyses of housing construction. Finally, it is important to distinguish wherever possible between housing that is constructed with and without subsidies. The existence of subsidies shifts incentives and may conceal the effects of regulation so long as the subsidies are in existence. In this study, it is possible to identify subsidized housing only for Los Angeles. However, the level of subsidy and

the number of units constructed has been relatively small during the period of rent stabilization, so the impact of subsidies on the market as a whole has probably not been significant.¹

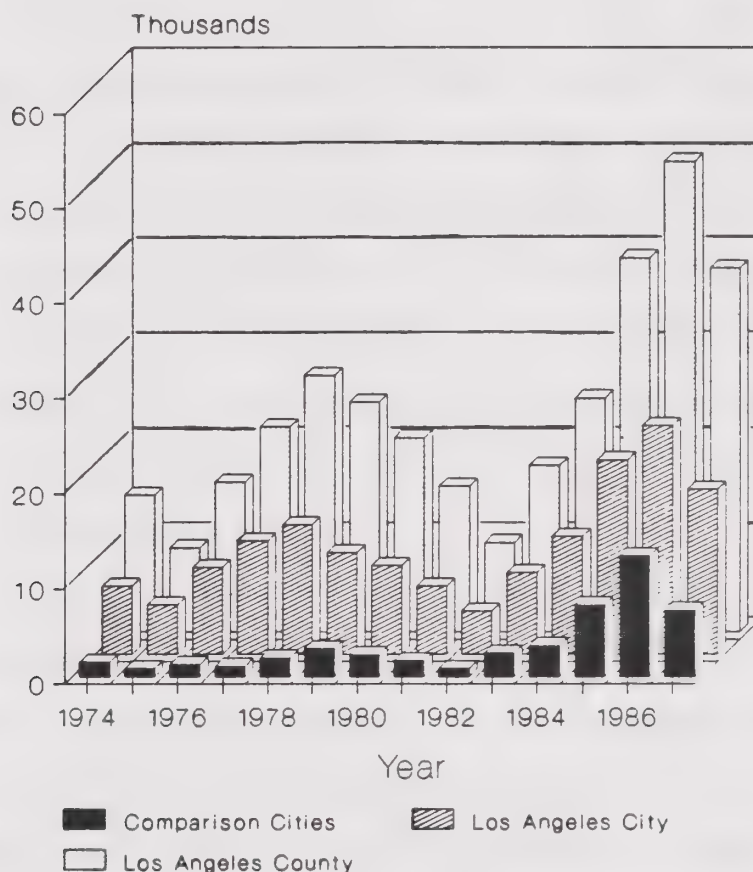
Chart 2.10 shows the pattern of construction of new multi-family housing in Los Angeles since 1974. Also shown in Chart 2.10 for comparison are data for Los Angeles County and for six cities that have not had rent stabilization. These cities are the same group as in the 1985 study. Although they are individually diverse in population and character, together they form a composite that is not dissimilar to Los Angeles. In reviewing the Chart, the reader should be aware that Los Angeles County did engage in some regulation of rents from July 1979 to January 1985, but in such a mild form that it is unlikely to affect investment decisions.

1			
<u>Year</u>	<u>New Construction</u>	<u>Low/Moderate Income Subsidized New Construction</u>	<u>Subsidized Percent</u>
1984	12,464	902	7%
1985	20,507	2,215	11
1986	24,093	1,634	7
1987	17,426	1,451	8

Source: Los Angeles Department of Building and Safety, and Rent Stabilization Division.

CHART 2.10

**MULTI-FAMILY HOUSING PRODUCTION IN LOS ANGELES CITY,
SIX COMPARISON CITIES, AND LOS ANGELES COUNTY: 1974 TO 1987**



The Chart shows that new construction of multi-family housing in Los Angeles has certainly not stagnated. Following the inception of rent stabilization, over 115,000 units were built between 1979 and 1987, an average of almost 13,000 units per year. In comparison with the City's estimated total of 616,000 existing multi-family units in 1980, this is a very respectable performance. However, production was not evenly distributed during the period.

The variation in construction over time is strikingly apparent in Chart 2.10.¹ As was indicated in the 1985 report, following the recovery from the severe housing recession of 1974-75, production rose to over 13,000 units in 1978. Then, from 1978 to the low point of the recession in 1982, annual production fell to about 4,500 units, a 67% decline. Although it coincided in time with the initiation of rent stabilization, this fall cannot simply be attributed to this event, since in the same period production in the comparison cities fell by 56%, and in the County it fell by 65%. However, the decline did occur first in Los Angeles, while production continued to rise for one year, 1979, in the comparison cities.

The subsequent market collapse from 1979 to 1982 was even sharper in the comparison cities and in the County as a whole than it was in Los Angeles. As we suggested in the earlier study, this probably means that the initial impact of rent stabilization may have been a withdrawal of housing investment from the city, but that experience with the Ordinance led to a reconsideration of Los Angeles as a profitable location for rental housing.

The pattern of new construction in the following years tends to support this view. From 1982 to 1986, new multi-family construction in Los Angeles exploded by 531% to a high of over

¹See Technical Appendices for tabular data used to construct Chart.

24,000 units, an increase almost identical to the 525% rise registered in the County. But, production in the comparison cities rose at an even faster rate.

Chart 2.11 provides a different way of looking at this experience, namely the relative scale of multi-family housing unit production in Los Angeles compared to the total of the six comparison cities, and to the Los Angeles County as a whole. In this Chart, multi-family housing production in Los Angeles is expressed as a percentage of total production in the six-city comparison city group, and in the County as a whole. It is striking that in the years following rent stabilization, the Chart shows that the City's proportion of total County production nevertheless rose continuously, from about 44% in 1979 to 52% in 1985. Only in 1986 did the proportion fall for the first time. In relation to the comparison city group, which had a much smaller total output than the City, the relation is the same from 1979 to 1982. From that time, the proportion fluctuates and then falls, reflecting the very rapid increase in construction in those cities during the mid-1980s.

CHART 2.11

NEW MULTI-FAMILY CONSTRUCTION IN LOS ANGELES AS A
PERCENTAGE OF CONSTRUCTION IN THE SIX-CITY COMPARISON GROUP,
AND OF SUCH CONSTRUCTION IN ALL OF LOS ANGELES COUNTY, 1979-1987

Los Angeles New Multi-Family Construction as a Percent of:

<u>Year</u>	<u>Comparison Cities</u>	<u>Los Angeles County</u>
1979	363.0%	44.4%
1980	407.1	45.9
1981	428.8	46.8
1982	524.8	48.1
1983	345.8	49.1
1984	380.5	50.7
1985	271.1	52.1
1986	190.2	48.6
1987	248.5	45.5

Thus, the argument advanced in the 1985 study to the effect that rent stabilization had been largely discounted by the market seemed to hold true for the succeeding years. This is not, of course, to suggest that there were no problems in rental housing production in Los Angeles. Production in the City declined by 27% in 1987, a sharper drop than occurred in either the County or the comparison group of cities.¹

¹The City decline, however, was less than the 33% decline experienced Statewide. It should also be noted that the magnitude of the 1986-87 decline at all jurisdictional levels is exaggerated by the record building permit activity that occurred in December 1986, as builders sought to obtain permits prior to the effective date of AB 2926, which allow school districts to impose fees of \$1.50 per square foot on new housing. Construction Industry Research Board, "State and Local Trends in California," paper presented at the 36th Annual UCLA Business Forecasting Conference, Los Angeles, December 16, 1987.

This decline may be the result of new restrictions on development in the City. Traffic problems and the perception of diminishing environmental quality are changing the way in which development occurs. The emergence of these issues seems to parallel the increasing tendency for developers to turn to sites with existing buildings for demolition and replacement, as raw land becomes harder to find. Such demolitions of multi-family housing reached a new high of over 2,000 units in 1986.¹ It is to these local changes in the regulatory environment, and their possible effects on future rates of new multi-family construction, that we turn next.

Changes in the Regulatory Environment

The growth in population and construction activity (including the explosive growth in multi-family construction described above) that has fueled the emergence of Los Angeles as the nation's second largest city and as the financial capital of the Western U.S., have not been without effects on the City's environment and its residents' sense of tranquility. Recent citizen-sponsored efforts and City Council policies to alter the City's growth trends, together with various other changes in the regulatory environment quite apart from the Rent Stabilization Ordinance, have placed new restrictions on the rate and scale of new construction in Los Angeles, including the construction of multi-family housing. Some of these changes, such as construction

¹Los Angeles Department of Building and Safety.

moratoria, have been aimed directly at perceived problems attributed to specific multi-family housing construction projects, particularly in areas experiencing a sudden increase in the number or scale of such projects.

This section reviews the effects on multi-family residential construction implied by four recent local land use regulation changes:

- # Proposition U, the 1986 voter initiative that ushered in a wave of citizen-initiated growth control activities and changes in the local politics of growth.
- # The AB283 Consistency Program, a court-ordered program of citywide re-zonings to achieve consistency between the City's 35 Community Plans (which make up its General Plan) and its zoning regulations.
- # Moratoria and Interim Control Ordinances, which are being adopted by the City Council with growing frequency, and often as a response to citizen complaints about the scale of specific development projects or clusters of projects.
- # New City environmental review procedures resulting from a recent judicial decision in the matter of Friends of Westwood, Inc. v. City of Los Angeles.

Other local regulatory changes, such as increases in multi-family construction-related fees are also noted.

Proposition U

In early 1986, Councilmen Yaroslavsky and Braude began a signature gathering effort to qualify for that year's ballot an initiative which was intended to reduce by half the allowable density of commercial development in approximately 85% of the commercial and industrial land in the City.¹ That measure, Proposition U, eventually qualified for the ballot and was approved by more than a two-to-one margin, garnering nearly 70% of the vote. The Proposition amended the permitted density of development for all commercial and industrial parcels located in Height District No.1,² from 3.0 times the lot area to 1.5 times the lot area.

The primary beneficiaries of the change are expected to be residents of neighborhoods near commercial streets in Height District No.1, who, in many parts of the City, have been experiencing the traffic and other consequences of ever larger projects built on adjoining commercial streets. Multi-family housing was

¹Sam Hall Kaplan, "The War to Save the Neighborhood," L.A. Times Magazine, October 26, 1986, page 16.

²Property in Los Angeles is divided into 30 zones, and each land parcel is also assigned to one of four basic "height districts." Whereas, the zones regulate the use of land, height districts regulate maximum allowable heights (in number of feet and stories) and maximum allowable floor area of buildings and structures. In Height District No. 1, buildings are regulated as to floor area only and not by height, unless properties are classified in one of several subsets of Height District No. 1 (e.g., "L" Limited Height District restricts building heights to six stories and 75 feet; "1-VL" Very Limited Height District restricts buildings to three stories and 45 feet; "1-XL" Extremely Limited Height District restricts building heights to two stories and 50 feet).

effectively exempted from Proposition U by simultaneous voter approval of another City Council sponsored Proposition¹ that was placed on the same ballot as Proposition U. This Proposition provided that a commercial lot in Height District No. 1 that is developed for residential purposes may continue to be constructed at a density of 3.0 times the lot area.² Furthermore, a project that combines residential and commercial uses on a commercially zoned lot in Height District No. 1 may also continue to be constructed at a density of 3.0, provided the commercial floor area of the project does not exceed 1.5 times the lot area. Therefore, very little new housing construction is likely to be reduced in scale or curtailed as a direct result of Proposition U. Furthermore, the Proposition does nothing to prevent a land owner from seeking either a change in Height District or a change of zoning classification in order to avoid the effects of the Proposition.

While the passage of Proposition U is likely to have only minor direct effects on multi-family housing construction, it has symbolic significance as a watershed for growing discontent among Los Angeles residents about the effects of construction activity in general. This political climate has resulted in an unprecedented number of recent construction moratoria, Specific Plan stud-

¹Proposition W, enacted as Ordinance 161,684, effective November 3, 1986.

²Los Angeles Municipal Code (LAMC) Section 12.21.1A.

ies and other regulatory actions that in many cases have reduced both the rate and the average scale of new multi-family residential construction in the City.

Although controlling growth is a relatively recent policy concern in Los Angeles, it has emerged at a time when an increasing number of local and countywide growth-limiting initiative measures that are making their way to the ballot in jurisdictions throughout Southern California.¹ If this trend continues, and growth control measures find the support among voters that most have in recent years,² new construction in general, including multi-family housing construction, may become increasingly difficult to accomplish.³

¹One recent inventory catalogued 177 such measures attempted in California between 1971 and 1988, with 44% of the total appearing on ballots in 1986-1988. California Association of Realtors, "Matrix of Land Use Planning Measures" (undated). The most recent development in this "ballotbox zoning" trend is the increasing frequency of countywide measures, either in tandem with or instead of, city-specific measures. In Southern California, growth control measures will be on 1988 ballots in Orange County, Riverside County and San Diego County. William Fulton, "Growth Movement Gains Momentum," California Development Report, April 1988, pp.4-5. No such measure has yet been proposed in Los Angeles County.

²Of the 177 measures catalogued by the CAR, 52% passed.

³The John E. Anderson Graduate School of Management at UCLA, The UCLA Business Forecast for California, March 1988, p.31.

The AB283 Consistency Program

A contemporaneous regulatory event with a much more direct impact on construction of multi-family housing is the City's so-called Consistency Program. This program has its origin in 1979 State legislation that requires all California charter cities to make their zoning ordinances "consistent" with their General Plan by July 1, 1982.¹ The City of Los Angeles' 1946 Zoning Ordinance pre-dates its 35 Community Plans, which are the key land use portion of the City's General Plan, and the Zoning Ordinance generally permitted more development to occur than was contemplated by the Community Plans. Movement toward consistency in Los Angeles therefore implies a general reduction in Citywide development potential.

The City unsuccessfully challenged the constitutionality of the legislation,² and then slowly began in 1982 the immense process of re-zoning some 200,000 inconsistent land parcels. Despite the deadline in the State legislation, the City succeeded in obtaining legislative time extensions until 1984. In September 1984, however, a State bill that would have given the City until 1987 to comply with the consistency mandate was vetoed by the Governor. When the City failed to expedite the program in the face of the veto, a coalition of 42 homeowners groups from the

¹AB 283, California Government Code Section 65860(d).

²City of Los Angeles v. State of California, 138 Cal. App 3d 526 (1982).

City's Westside and San Fernando Valley areas sued the City, demanding quicker compliance and an order restraining the City from issuing building permits for projects that would be inconsistent with the applicable Community Plan.¹

In February 1985, Los Angeles Superior Court Judge John L. Cole ruled for the homeowners, granting a writ mandating the City to complete the consistency process within four months. The City then settled the case with the plaintiffs, rather than appeal the judgment. The settlement stipulation did not include a ban on building permits for inconsistent parcels. Instead, it caused the adoption of an interim Ordinance governing the issuance of building permits for such parcels during the period until consistency had been achieved, and it extended the time for reaching this point from four months to three years. The stipulation also empowered the Court to appoint a Referee to monitor the City's compliance with this newly enacted Interim Permit Consistency Ordinance.² In January 1988, the deadline was extended to December 31, 1988.

¹Federation of Hillside and Canyon Associations, Inc. v. City of Los Angeles, Case No. C 526,616, Judgment filed Feb. 1, 1985.

²Ordinance No. 159748, (effective Apr. 3, 1985). Francine F. Rabinovitz, one of the co-authors of this Report, currently serves the Court in this capacity.

As of April 1988, consistency recommendations for parcels in all 35 Community Plan areas have been prepared for review by the City's Planning Commission, and the City Council has adopted recommendations concerning about half (51%) of the areas, as shown in Chart 2.12, below:

CHART 2.12

AB 283 CONSISTENCY PROGRAM STATUS SUMMARY, APRIL 1988

<u>REVIEW STATUS</u>	<u># AREAS</u>
Completed Planning Commission Review	39
Pending Planning Commission Review	<u>11</u>
Subtotal	50*
Completed City Council Adoption	26
Pending City Council Adoption	<u>13</u>
Subtotal	39

* Total exceeds the actual number of Community Plan areas (35) because some Community Plan areas have been divided into subareas to address particular consistency situations.

SOURCE: City of Los Angeles, Department of City Planning.

The general result of the Consistency Program has been to reduce the overall development potential of land parcels in the City, and the total population that the City can accommodate: the 35 Community Plans would accommodate a residential population of about 4,000,000, or one-third less than the population that could be accommodated under the pre-Consistency Program Zoning Ordinance.¹ From the beginning of the program, it has also been

¹These figures consider population in residentially zoned areas only. If one adds possible residential population in commercial zones, the comparison is from about 10 million people in the pre-consistency system to 8 million in the post-consistency world.

expected that the Consistency Program probably meant that fewer multi-family housing units would be built in the City in the future than would have been possible under the old Zoning Ordinance.

For example, a survey of projects pending permits at the time the Interim Consistency Ordinance was enacted found 75% of multi-family residential projects to be inconsistent with the applicable Community Plan. The Chief Examiner for the Planning Commission observed that strict consistency with the General Plan would "stymie the development of housing, particularly affordable housing."¹ Another indicator of the degree to which the Consistency Program was projected to affect multi-family construction emerged from a 1985 City study of projects eligible for the "grandfather clause" in the Interim Ordinance,² which allowed projects caught in the permit pipeline at the time the program went into effect to be developed even though inconsistent if equity demanded such a result. This study estimated that substantial numbers of pending apartment buildings exceeded the density or other standards in the applicable Community Plan, and would likely be determined to be inconsistent.³ However, the application of the grandfather clause in the Interim Consistency Ordinance

¹Id., pp.4-5

²Ordinance 159748, Sec. 36.

³Referee's Report, op. cit., pp. 20-28.

nance did permit approval of approximately 230 inconsistent apartment projects that exceeded Community Plan densities by 25% or more.

Another provision of the Ordinance¹ permits the City Planning Commission to approve construction of rental housing projects that exceed Community Plan densities if such projects contain specified percentages of dwelling units for low and moderate income households, and also provides that specified findings of general neighborhood compatibility can be made. Since adoption of the Interim Ordinance, approximately 100 projects including some units of affordable housing have been approved utilizing this "additional authority" of the City Planning Commission.

The early signs indicating a likely reduction in future residential construction appear to have been borne out as the Consistency Program has unfolded during the past three years. Chart 2.13 below shows the reduction in the number of residential units that could theoretically² be constructed in 17 Community

¹Ordinance 159748, Section 9.

²The analysis multiplies the acreage of the "inconsistent" parcels by the permitted residential density before and after consistency. This does not account for dwelling units already on these parcels, nor whether or not there is market demand for the number of units the new zoning would theoretically permit to be constructed. For zoning districts which permit a range of dwelling unit densities, the analysis assumed the midpoint density in that range (e.g., one unit per 600 square feet of parcel area in the R4 District). The analysis does not include calculations of possible residential development on commercially or industrially zoned land.

Plan areas, or portions of Community Plan areas,¹ after adoption by the City Council of the zoning changes needed to accomplish consistency in those areas of the City.

¹As noted above, some of the City's 35 Community Plan areas have been subdivided for purposes of the Consistency Program. Of the 20 areas where Consistency Program changes have been approved by the City Council, the City's documentation for three areas (Pacific Palisades-Brentwood, San Pedro and Boyle Heights I) did not include acreage figures for parcels that were subject to consistency changes, and therefore no "before" and "after" calculations could be made.

CHART 2.13

NET CHANGE IN MULTI-FAMILY DWELLING UNIT CAPACITY RESULTING FROM
THE AB 283 CONSISTENCY PROGRAM IN 17 COMMUNITY PLAN AREAS

<u>Area</u>	<u>Acres</u>	<u>Pre- Consis- tency D.U. Capacity</u>	<u>Post Consis- tency D.U. Capacity</u>	<u>Absolute Change</u>	<u>Percent Change</u>
Canoga Park	1,420	17,538	1,670	<15,868>	-90%
Central City	124	256	17,243	16,987	+6636%
Central City North	72	4,474	3,502	< 972>	-22%
Granada Hills	3	481	96	< 385>	-80%
Mission Hills	74	4,745	1,555	< 3,190>	-67%
Northridge	16	559	388	< 168>	-31%
Palms-Mar Vista	392	25,248	12,692	<12,556>	-50%
Reseda-West Van Nuys	105	5,889	3,144	< 2,745>	-47%
Silver Lake	1,267	61,321	25,167	<36,154>	-59%
South Central	1,940	88,207	39,972	<48,235>	-55%
Sunland- Tujunga	236	11,757	6,009	< 5,748>	-49%
Sylmar	86	4,291	2,238	< 2,053>	-48%
Venice I*	78	4,227	1,514	< 2,713>	-64%
West LA	124	7,202	3,468	< 3,734>	-52%
Westlake I*	<u>475</u>	<u>38,082</u>	<u>21,200</u>	<u><16,882></u>	<u>-44%</u>
TOTAL	6,410	274,277	39,858	<168,390>	-49%

* Portion of a Community Plan Area.

In addition, another 23,129 multi-family units in these same 17 Community Plan areas that would otherwise have been theoretically eligible to be developed as a matter of right will now be subject to a discretionary review process similar to a conditional use permit. Although these parcels bear a multi-family residential zoning designation, the Community Plan maps indicate them to be in an open space land use category, and therefore special approvals will be required before they may be developed for residential purposes.

Moratoria, Interim Control Ordinances and Specific Plans

Both State law and Los Angeles Ordinances permit the City to adopt zoning ordinances and other regulations to implement the goals, purposes and policies of its General Plan and its associated Community Plans, and to enact special procedures to resolve problems created by unforeseen consequences of zoning regulations. Among such planning tools are moratoria, interim control ordinances and Specific Plans. These tools have been used increasingly in Los Angeles over the past 15 years to resolve problems related to consistency issues, and to the serial nature of Community Plan preparation, adoption and revision. Moratoria have been adopted to stop specific development projects while alternative zoning regulations or Specific Plans are studied and enacted.

More recently, and in light of a 1987 ruling by the U.S. Supreme Court in First Lutheran Church v. County of Los Angeles¹ which raises the spectre of money damages when government regulation "goes too far," Interim Control Ordinances have been used instead of moratoria as a prelude to preparation of an alternative zoning ordinance or a Specific Plan. In many instances City actions to initiate changes through the moratorium, interim control ordinance or Specific Plan processes have been triggered by concerns associated with proposed multi-family housing projects. In almost every instance these City actions have meant changes in the procedures or rules for developing multi-family projects. In the wake of both Proposition U and the AB 283 Consistency Program, these tools are being used with increasing frequency.

¹107 U.S. 2378 (1987). The case involved a suit for damages against the County resulting from enactment of a temporary flood plain moratorium. The Church sued for damages on the grounds that the Ordinance resulted in a taking of its property without just compensation. The Supreme Court held for the first time that a moratorium may result in such a taking and that money compensation is the appropriate remedy under the Fifth Amendment. The Court also ruled that damages must be awarded for the interim period during which the regulation is in effect.

State law¹ and local ordinances² allow the City to adopt an emergency moratorium on construction projects whenever the City Council determines that existing conditions present an imminent threat to the public health, safety and welfare. That is, the City may adopt such moratoria on the approval of additional subdivisions, use permits, variances, building permits, or any other applicable entitlement for use which is required in order to comply with a zoning ordinance when such an approval would result in a threat to public health safety, or welfare.³ These moratoria are typically enacted on a short term basis to permit City staff time to study and propose alternative regulations for a particularly problematic type of development (e.g., mini malls) or alternatives for development in a particular location that exhibits some new or unforeseen problem, or even when there has simply been an unexpected and rapid increase in the number of permitted projects. In some cases, moratoria are adopted specifically to permit the time needed to prepare a Specific Plan.

¹Government Code Section 65858.

²According to City Planning Department staff, there is no specific statutory base for adopting a development moratorium. Los Angeles instead relies on its general governmental authority to enact emergency ordinances. The Planning Commission is currently studying proposed policies for notice and public hearings on proposed development moratorium ordinances, which are now adopted without formal written notice to property owners and tenants.

³Government Code Section 65858(d).

Moratoria enacted by the City in recent years frequently involve multi-family residential projects or areas, such as the Westside, experiencing growth pressures from multi-family housing. The 36 moratorium ordinances that have been adopted since 1974 are listed in the Technical Appendices to this Report.

Under California's planning laws,¹ Specific Plans are permitted for the purpose of implementing local General Plans through preparation of area-specific policies and regulations at a level of detail and integration that is often not otherwise possible using more traditional planning tools and regulations, such as General Plan Elements and zoning laws. Specific Plans often combine land use policies, zoning regulations, capital improvement plans, detailed development standards and other regulatory schemes into one document that can be tailored to meet the needs of a specific geographic area.² This approach is particularly well suited to geographically or spatially distinctive subareas of a city, or subareas experiencing specific problems (e.g., rapid change or unusual infrastructure needs) that cannot be properly addressed by other regulatory means. Preparing a Specific Plan usually involves considerable time and effort.

¹Government Code Section 65450 et seq.

²Governor's Office of Planning and Research, Specific Plans: How Some California Communities Use Them, State of California, April 1981, p.7.

In Los Angeles, both the City Charter¹ and the Municipal Code² provide for the preparation and adoption of Specific Plans. Since 1971, 14 such plans have been adopted, all but two of which have been enacted since 1980. In addition to these adopted Specific Plans, 14 other Specific Plans are currently in preparation by the City Planning Department. A list of adopted and pending specific plans is also included in the Technical Appendices.

Local Coastal Land Use Plans, which are similar to Specific Plans, have either been adopted or are also under preparation in all Los Angeles communities, or portions of communities, that are located within the Coastal Zone.

New Environmental Impact Regulations

Although recent amendments to the California Environmental Quality Act (CEQA) have been enacted specifically to reduce the cost and time burden of environmental review of housing projects,³ a recent decision by the California Court of Appeal in a case involving a proposed high-rise office building in Westwood

¹Charter of the City of Los Angeles, Article VIII, Section 97.1.

²LAMC Chapter 1, Section 11.5.7.

³For example, Public Resources Code Sec. 21085, added in 1982, states that a public agency shall not reduce the proposed number of dwelling units in a project as a measure to mitigate adverse environmental impact if it determines that there is another feasible mitigation measure available that will provide a comparable level of mitigation.

has precipitated a new set of environmental review procedures for all construction projects, including multi-family housing projects, that had previously been exempted from such review. In Friends of Westwood, Inc. v. City of Los Angeles,¹ the Court found that not all building permits are "ministerial" (i.e., automatically granted) in nature, but rather may involve a degree of discretionary judgment on the part of City officials that brings the action within CEQA's boundaries for environmental review. Although the high-rise office tower project that was the subject of the case conformed to all applicable zoning rules, and therefore required no special permits from the Planning Department or City Planning Commission which would have triggered review under CEQA, the Court found that the City in fact exercised considerable discretion in imposing standards and conditions on the building permit as it was processed through the Department of Building and Safety's Plan Check procedures. The Court determined that the issuance of building permits concerning the characteristics of the project under review constituted a discretionary action, and therefore should have been reviewed under the City's CEQA guidelines.

In response to this ruling, Mayor Bradley issued a directive in July 1987, ordering the Department of Building and Safety to comply with the Friends of Westwood decision by revising its

¹191 Cal.App.3d, 259 (1987).

procedures to conduct environmental review for any project filed for Plan Check on or after August 17, 1987 which meets the following thresholds:

-- Any project which creates or adds over 40,000 square feet of floor area.

-- Any project which creates or adds over 35 dwelling units or guestrooms.

-- Any project more than 25 feet in height which creates two or more dwelling units or guestrooms within 50 feet of a lot classified in the RW1 (Residential Waterways Zone, such as lots fronting the Venice Canals) or a more restrictive zone.

-- Any project which generates 500 or more average daily automobile trips.

The Mayor's directive also required that new procedures be established to implement this order. These included making the Department of Building and Safety the "lead agency" on all building permit CEQA reviews, with appeals possible to the Building and Safety Commission, and notifying Council Offices of any requests for CEQA clearances within their Districts. The resulting procedures include a CEQA review process that parallels and overlaps the system already in use by the Department of City Planning and the City Planning Commission. As of mid-March 1988,

most projects to date that were subject to these new procedures had been granted a Negative Declaration with respect to environmental impact. Only one project, a 300-unit multi-family residential project, has been required to prepare an Environmental Impact Report, which is still in process. One observer close to the situation suggests that these new procedures will probably create permit processing delays and project scale modifications.¹ While this may result in more environmentally harmonious projects, it will also probably add new, unknown costs to the City's development process, affecting larger multi-family housing projects as well as other types of larger scale construction.

Construction Fees and Other Development Permit Costs

Although the cost of land and construction financing are the factors that probably have the greatest effect on the cost of housing construction, other "soft costs," particularly regulatory fees, appear to be consuming a greater percentage of total housing development costs.² Market conditions typically determine who bears the incidence of these costs. In highly desirable locations, where housing demand is price-inelastic (i.e., relatively insensitive to changes in price, such as many areas of the Westside), it is often possible for builders to pass additional

¹Anthony Alperin, "World Class City or Freeway Parking Lot: Development in Land Use Controls in Los Angeles," Los Angeles Lawyer, November 1987, p.24.

²A recent study in the San Francisco Bay Area by the Bay Area Council found such fees adding as much as 10% to the price of new suburban homes. (San Francisco Chronicle, May 17, 1988.)

regulatory fees along to consumers in the form of higher rents. In other areas where the market is more price sensitive, fee increases may be passed back to landowners in the form of lower purchase prices. In yet other instances, where market conditions permit neither renters nor landowners to absorb these cost increases, builders may have to absorb the costs, and may respond to this situation by cutting back production to preserve profit margins.

Although it is not possible to determine precisely how this dynamic plays out in the context of a complex housing market such as metropolitan Los Angeles, development permit fees for multi-family housing are increasing over time. For example, between 1984 and 1987, application fees for zoning amendments increased by 76%, the fee for subdivision maps increased 45%, and the fee for Initial Studies needed for environmental clearances increased 69%. These types of increases may yet emerge as another factor among the many that will influence future housing supply.

Conclusion

The Los Angeles housing market is huge, complex, and constantly changing. As this Chapter has shown, it is subject to many influences, among which rent stabilization is important but probably not the most powerful. The picture revealed over the past ten years is one of great fluctuations in multi-family rental housing production. These changes have been driven pri-

marily by shifts in demand, due to demographic changes, and in supply conditions, especially interest rates and tax treatment of rental housing investment. Overall, the outcome has been positive, with new housing construction at high levels in recent years and vacancy rates gradually rising toward the 5% level. For this to have occurred in a period of heavy immigration is fortunate. Otherwise, the City would be facing a severe housing crisis.

Nonetheless, there are also serious and disturbing trends. Rising housing densities and loss of single-room occupancy housing are symptoms of the underlying pressures that give rise to homelessness. Changes in the tax code are making construction of new rental housing less profitable and may push up initial rents. Finally, the emergence of new regulations on production of multifamily housing will inevitably raise costs and reduce production in the future. Los Angeles seems to be moving toward a new phase in its development, in which the rate of physical growth of the City will be significantly lower than its historic level. In such circumstances, the role of the existing housing stock becomes even more important, especially as the source of housing for low and moderate income households. How rent stabilization affects the stock is therefore a critical question, to which we turn in the following Chapters.

CHAPTER 3

THE IMPACT OF RENT STABILIZATION ON TENANT HOUSEHOLDS IN LOS ANGELES

This Chapter focuses on five basic questions:

- * What are the basic characteristics of the rent stabilized population in the City?¹
- * How do the average characteristics of the rent stabilized population compare to those of Los Angeles households who occupy unstabilized rental housing?
- * How has the average situation of tenants in stabilized units principally changed since 1984?
- * What financial benefits or costs accrue to tenants as a result of rent stabilization, and how have these changed in recent years?
- * What proportion of these benefits and costs flow to low income and/or elderly households?

The data gathered and analyzed for the present study were mainly derived from a systematic telephone survey of tenants conducted in late 1987. The comparative analyses presented herein result from juxtaposing the 1987 data and the information derived in the similar telephone survey that was conducted in 1984 as part of the initial review of the impact of the Rent Stabilization Ordinance. Both surveys are described below and

¹As noted earlier, these estimates of impact do not include rent stabilized households who live either in mobile homes or in Single Room Occupancy hotels.

certain differences between them are noted. The differences are not sufficient, in our opinion, to materially affect the validity of the comparative and trend analysis presented.

Nevertheless, certain caveats should be noted at the outset. First, both data bases consist entirely of tenant reports that cannot be verified in any independent manner. The 1984 tenant survey, which, unlike its 1987 counterpart, was accompanied by a simultaneous written/interview survey of building owners, showed a wide and systematic discrepancy between the average of tenant-reported rent levels and the average of those reported by building owners. However, data from independent sources suggested that the tenant reports were the more accurate. And, the comparisons made here are between 1984 tenant reports and 1987 tenant reports so that, unless there has been some systematic change in the incidence of inaccurate tenant reporting as between the two years, comparisons between them are appropriate even if both have some error incidence. These factors give reason for confidence in the comparisons, but the reader should still be aware of the single source of the data base.

Second, collective figures always mask a welter of very different individual situations. Thus, the situations of large numbers of tenant households vary dramatically from those of the average household, even within the various subgroupings employed for analytic purposes. Third, because there is no perfectly accurate means of constructing the world that would have evolved

if rent stabilization had not been enacted in Los Angeles, there is no perfectly accurate way to measure the marginal dollar benefits or costs of stabilization. As shown in the previous Chapter, myriad factors other than government regulation can and do affect the behavior of rents. Although the vacancy decontrol feature of the Los Angeles regulation regime tends to assure that overall average rents will approximate the overall average exhibited by "free-market" rents over some economic cycle, the length of this cycle probably varies greatly depending upon macroeconomic conditions and events. Therefore, the marginal benefit and cost estimates presented in this Report should be considered approximations which, although probably correct in direction, are not necessarily precise.

Basic Methodology

Most of the new data presented and analyzed in this Chapter were collected in telephone surveys involving more than 1,700 renters residing in the City of Los Angeles in the late Fall of 1987. The survey sample included:

- * 1,422 tenants residing in rent stabilized housing units.
- * 301 tenants occupying unstabilized units built between 1978 and 1987¹.

¹It will be recalled from Chapter 1 that, in addition to units occupied after May 1, 1978, the RSO excludes coverage of (i) units subsidized by large public programs, chiefly in the form of Federal Public Housing projects and what are known as "Section 8" rent supplements; (ii) hotel/motel housing in which the tenant does not rent the space for at least 60 days; (iii) housing owned by educational institutions; (iv) units that have been substantially renovated; (v) units whose rents were then above dollar levels specified by the original RSO as "luxury" thresholds; and (vi) units occupied by the building owner or

The vast majority of the interviews (83%) were conducted during the month of November 1987, although a few were conducted in the last days of October and the first half of December of that year.

In the case of tenants in stabilized units, an initial random sample of 1,163 respondents was derived through random digit telephone dialing. Because the assignment of the 1988 study, unlike the initial review, included an analysis of the differential impact of the RSO in various parts of the City, this initial sample was then supplemented to the degree necessary to assure that there were at least 50 respondents in each of the 13 community areas described and mapped in Chapter 1. This supplementation was accomplished by adding 259 tenants selected through random sampling using reverse telephone directories (i.e., directories which move from address to telephone number) for given geographic areas. All results received from the total sample of 1,422 stabilized households were then weighted to represent the distribution of rental housing in the area as reported by the 1980 Census of Population.

members of his/her immediate family. None of these non-covered categories were included in the telephone survey of unstabilized households because, with the exception of the luxury/recent rehabilitation ones, all represent specialized tenant populations whose circumstances would skew the averages derived from the less specialized households. And, the number of households in the luxury/recent rehab group is so small (only 3,212 units have been excused for this reason since the outset of the stabilization program) that the odds against their being represented in any survey were very long indeed.

In the case of the unstabilized renter population, just over half the total (55%) were identified in the course of the initial random digit dialing performed in order to contact the sample of stabilized tenants. When this process did not generate enough unstabilized respondents to achieve the desired sample size of 300,¹ the necessary additional number was obtained from a random sample of all multi-family buildings constructed pursuant to building permits issued by the City Department of Building and Safety between October 1, 1978 and December 31, 1986. A list of the phone numbers in these buildings was identified through the use of reverse telephone directories. A random sample of these phone numbers yielded the additional unstabilized respondents.

The work performed by the consultants was augmented by a separate, City-conducted study in November 1987 of the rents planned to be charged in buildings where construction was completed in that year but which were not yet occupied. This survey covered 7,425 units in all 179 buildings whose Certificates of Occupancy were issued in 1987. All owners of such buildings who

¹Assuming that the researcher has a 95% confidence level in the proportion in question, a sample of 300 yields an error range due to sampling of plus or minus 5.7%. This was felt to be the maximum range that could be permitted in this context.

agreed to cooperate were interviewed and supplied data on the rents to be charged for units of various sizes, and the building-by-building distribution of unit sizes was then estimated¹.

While similar in many respects, the tenant surveys conducted by the consultants in 1987 differed from the 1984 tenant surveys in several ways. First, for reasons of project economy and the low marginal improvement in accuracy involved in larger sample size,² the 1987 samples were a bit smaller than the 1984 versions. Whereas the 1984 telephone survey involved 2,299 stabilized households, the 1987 survey involved 1,422. Similarly, whereas the 1984 complement of unstabilized households totalled about 400, the 1987 survey included just over 300. In addition, the 1984 work involved a special add-on sample of 50 households which had no telephones, in order to check whether the telephone survey suffered from noticeable skewing because it reached only households with phones. Since it was discovered that this was not the case, and that the differences between households that did and did not possess telephones were satisfactorily captured

¹Owners or managers of about half (90) of the 179 buildings provided data on rents and unit sizes. Data on the other buildings were collected by staff members in the role of apartment hunters. The probable distribution of unit sizes in these buildings was then estimated using data from the 1987 tenant survey of the rent stabilized population.

²A sample of 1,000 generates an error range of plus or minus 3.1%. Doubling the sample to 2,000, and thereby also doubling the cost of survey administration, shrinks the range to plus or minus 2.2%, a modest improvement at best.

by the income and racial/ethnic differentiations in the telephone survey data, this special sub-survey was not performed again in 1987.

Second, the 1984 survey of unstabilized households was conducted in the six comparison cities surrounding Los Angeles which had not enacted rent regulation, while the corresponding 1987 survey involved Los Angeles residents living in unstabilized units. Third, the 1984 sample of stabilized households was not adjusted to be certain that at least a minimum number of respondents were present from various geographic subareas into which the City was divided. As noted above, the 1987 sample was so adjusted, making it possible to draw comparisons between situations in the subareas, while also weighting the results according to the geographic balance of the incidence of rental housing so as not to skew the study's Citywide results.

The reader is invited to keep these differences in mind while reviewing the findings discussed in the sections below.

Tenant Knowledge That Their Rents Are Stabilized

One of the findings of the 1984 survey of tenants in rent stabilized units that was widely regarded as most surprising was the indication that, despite six years of recurring controversy over rent regulation that had been copiously reported by both print and electronic media, about two in every five tenants (41%)

who were apparently living in rent stabilized quarters said that they did not know whether or not their rents were subject to stabilization.¹

The 1987 survey results suggest that three additional years of sporadically publicized controversy have not lessened the problem of tenant unawareness. Indeed, this time, a slightly higher proportion (45%) responded that they did not know whether stabilization applied to their dwellings.² As so often happens in matters of public policy, the sense of the participants in the debate that everyone in the body politic is breathlessly attentive to the issue is once again belied by the existence of a large contingent who are oblivious to any benefit that they may be receiving from the government's current approach to the matter.

¹HR&A , The Rent Stabilization System, op. cit., p.10.

²As in 1984, all Los Angeles tenants interviewed were asked whether their units were covered by rent stabilization. If the respondent said he/she did not know, or that the program did not apply, he/she was then asked whether the building in which the unit was located had been built after 1979. Those who answered this question in the affirmative (and were not screened out by the questions inquiring into the applicability of the other exclusions from the program) were classified as living in unstabilized units. Those who passed through the other screening and said that the building was built before 1979 were classified as living in stabilized units.

Current and Comparative Status of Rent Stabilized Households

The basic characteristics exhibited by the Los Angeles tenant households in the 1984 and 1987 surveys are summarized on the following page in Chart 3.1.

As to household income, the figures in the Chart confirm that the core of the rent stabilized tenant population continued in 1987 to consist of households of modest to moderate income.¹ Sixty-five percent of the rent stabilized households reported annual incomes of less than \$30,000, and 40% earned less than \$20,000. By contrast, the unstabilized population was evenly split between those above and those below \$30,000, and the clear majority of those in the upper half of the unstabilized income profile reported earnings of more than \$40,000. Consequently, the average income of the unstabilized household was nearly \$31,000, or 19% higher than that of the stabilized household (about \$26,000).

¹The figures shown in the Chart and all household income numbers discussed henceforth in this Report refer to money income only, not to the total (including in-kind) income concept earlier identified with the Center for Continuing Study of the California Economy.

CHART 3.1

THE 1984 AND 1987 TENANT SAMPLES: HOUSEHOLD CHARACTERISTICS

	<u>1984 Survey</u>	<u>1987 Survey</u>	
	<u>Stabilized Units</u>	<u>Stabilized Units</u>	<u>Unstabilized Units</u>
Household Income: (percent distribution)			
<\$10,000	14%	11%	10%
10,000 - 19,000	33%	29%	21%
20,000 - 29,999	21%	25%	19%
30,000 - 39,000	8%	16%	20%
> 40,000	24%	19%	30%
Average Income:	\$23,634	\$25,931	\$30,754
Race/Ethnicity of Household Head: (percent distribution)			
White	53%	47%	52%
Black	19%	13%	6%
Hispanic	18%	31%	28%
Other	8%	9%	14%
Age of Household Head: (percent distribution)			
< 30 years	25%	24%	38%
30 - 61 years	59%	61%	56%
> 62 years	16%	15%	6%
Average Age of Head of Household:	42	42	37

The overall change in the income profile of rent stabilized households between 1984 and 1987 seems to have been modestly negative in real terms. The share of these households earning \$20,000 per year or less fell by 3% over the period. However, the fact that the average income of the stabilized group grew by only 9.7% while the regional CPI rose by 12.6%¹ during the same years indicates an overall average decline in real income² of nearly 3%. This retarded growth in average income was strongly influenced by the noticeable decline in the proportion of rent stabilized households with incomes of more than \$40,000, which fell from 24% to 19%. Although there are no 1984 data for unstabilized households to compare with the 1987 findings for those tenants, this reduction in the share of higher income tenants in stabilized units presumably reflected at least in part the decisions of better-off stabilized households to purchase some of the new quarters generated by the mid-80s boom in multi-family housing construction that was described in the last Chapter.

Moving to race/ethnicity, the results reported in Chart 3.1 indicate that the slim majority of White-headed rent stabilized households that was recorded in the 1984 may have given way to an equally slim majority of households headed by minority group members by 1987. But this change appears to have been not nearly

¹Changes in the cost of living were measured using the Los Angeles-Long Beach-Anaheim All Urban Consumer Price Index, which is estimated and published by the U.S. Bureau of the Census.

²I.e., income adjusted for inflation.

so dramatic as the shifts in composition between minority groups. The proportion of stabilized households headed by Blacks registered as declining by nearly one-third, while the share of Hispanic-headed households leaped upward by 42%. Meanwhile, the share of "Other" minority-headed stabilized households, which is dominated in terms of numbers by household heads of Asian extraction, also rose a bit. Although sampling error may tend to magnify the degree of the change, there seems little doubt that in these three years Hispanic-headed households moved from rough parity with those headed by Blacks in terms of shares of occupancy of rent stabilized housing to a share second in size only to White-headed households and significantly larger -- perhaps more than twice as large -- as the share headed by Blacks.

Just as striking is the fact that the share of Hispanic-headed households in the unstabilized stock was very nearly as large as their share of the stabilized households. Here again, the split between White- and minority-headed households was almost even, though the Whites registered a slim majority. But the total minority group share was dominated by Hispanic- and Asian-headed households, while the share of households headed by Blacks was quite small. Once again, the absence of corresponding data for 1984 makes it impossible to tell how this balance may be changing over time. Nevertheless, it is of interest that as of 1987 the balance between White and all minority group households was approximately even in both elements of the Los Angeles rental housing stock, stabilized and unstabilized.

In contrast to these dramatic shifts in racial and ethnic balance, the age group balance of the heads of rent stabilized households appears to have been virtually constant over the period 1984-87. The average age of the household head held constant at 42, and no age group changed its share of total stabilized households by more than 2%, which is well within the range of sampling error.

The relatively greater agedness of the rent stabilized population was documented both by the fact that the average age of the head of an unstabilized household was five years younger, at 37, and the companion fact that well over one-third of them were under the age of 30, whereas only about one-quarter of the heads of stabilized households were so youthful. And, at the high end of the age profile well over twice as large a share of heads of stabilized households were recorded as more than 62 years old.

In sum, as compared with 1984, the 1987 surveys suggest that Los Angeles households resident in rent stabilized units now tend to be a bit less well off in terms of real income, more likely to be headed by Hispanics and less likely to be headed by Blacks, and of almost exactly the same age profile. And, when compared to households in the unstabilized portion of the Los Angeles rental stock, stabilized households now tend to be significantly older,

clearly less affluent (at least in income terms¹), somewhat more likely to be headed by Whites or Asians, less likely to be headed by Blacks, and about as likely to be headed by Hispanics as is an unstabilized household.

Moving from the characteristics of the tenants of rental housing to the characteristics of the rental stock itself, Chart 3.2 on the following two pages summarizes the results of the 1984 and 1987 surveys in this regard.

¹Smaller households headed by older people sometimes have greater wealth (i.e., accumulated assets) than larger households headed by younger people who receive a greater flow of current income. This is far more true of homeowners than of renters, but there are still many cases in which current income can mislead if taken as a sole indicator of relative wealth.

CHART 3.2

THE 1984 AND 1987 TENANT SAMPLES: BUILDING AND UNIT CHARACTERISTICS

	<u>1984 Survey</u>	<u>1987 Survey</u>	
	<u>Rent Stabilized Units</u>	<u>Rent Stabilized Units</u>	<u>Unstabilized Units</u>
Number of Units in Building.			
1-5	31%	28%	16%
6-10	22%	23%	18%
11-20	19%	19%	22%
21-50	17%	20%	29%
51-100	6%	6%	9%
101+	5%	4%	6%
Median Number of Units	10	10	20
Number of Rooms in Unit			
1	8%	8%	6%
2	15%	14%	16%
3	32%	32%	27%
4	28%	30%	31%
5	12%	12%	16%
6+	5%	4%	4%
Average Number of Rooms	3.3	3.3	3.5

Number of Bedrooms in Unit

None (studio)	9%	9%	6%
1	50%	51%	39%
2	35%	34%	47%
3	5%	5%	8%
4+	1%	1%	0%

Number of Complete Bathrooms*

None	2%	1%	0%
1	81%	80%	58%
1.5	6%	8%	11%
2	9%	10%	22%
2+	2%	1%	9%

* A complete bathroom has a flush toilet, a sink or washbasin, and a bathtub or shower. A half bathroom has at least a flush toilet or a washbasin, but not a bathtub or shower.

As would be expected, the figures in Chart 3.2 indicate no significant change in average size or building distribution of stabilized rental housing over the three-year period. Since no newly constructed housing was added to this stock, either during this interval or at any other time in the history of rent regulation in Los Angeles, the only changes in its physical nature have come either from building demolition or from enlargement or downsizing of existing units. Looked at from the standpoint of the stock as a whole, the volume of this kind of activity is very small. The net change in the size of the stabilized stock between 1984 and 1987 was a reduction of only about 10,300 units, or about 2%.¹ Thus, there was virtually no physical change in the overall average building or unit size.

However, the 1987 survey makes possible the first systematic comparison of the stabilized and unstabilized stocks in these physical terms. The comparison highlights some interesting differences that are probably due to recent changes in the cost of developable land, as well as to changing consumer preferences for rental housing. First, the buildings in the unstabilized stock tended to be roughly twice as large as the buildings in the stabilized stock -- the median stabilized building contained 10 units, while its unstabilized counterpart had 20. The "mom and pop" building with 1-5 units that still made up more than one-quarter of the stabilized building stock was only about one-sixth

¹The two surveys indicate that the total stock registered for stabilization shrank from about 489,000 units in 1984 to about about 478,700 in 1987.

of the newer, unstabilized stock. And, whereas just over half of the stabilized buildings had 10 units or less, two-thirds of the unstabilized ones had more than 10 units, and 44% of them had more than 20.

Second, the survey indicated that, although the great bulk of the units in both stocks had one or two bedrooms, the majority of the stabilized units in this size range had a single bedroom whereas the majority of the unstabilized units had two. Taken together, one- and two-bedroom units comprised 85-86% of each stock, but the distributions between the one- and two-bedroom units were almost mirror opposites of each other. The figures also suggest that the one-room studio apartment may be becoming an endangered species, making up a share of unstabilized housing that was one-third smaller than the corresponding share in the stabilized stock. At the other end of the size scale, however, the unstabilized stock had a noticeably larger complement of three-bedroom apartments.¹

Third, the change in renters' amenity standards over the past decade is evident in the large increase in the incidence of 1.5- and two-bathroom units in the newer, unstabilized stock. Whereas four of every five stabilized units had no more than one bathroom, only about three of five unstabilized units had only

¹The fact that the unstabilized stock in the sample contained no four-bedroom or larger units is probably due to sampling variation. A larger sample would probably have turned up a few such units, though perhaps not in the proportion that they were found in the stabilized stock.

one. The proportion of unstabilized units with two full baths was double the proportion of such units in the stabilized stock. The trend toward a multi-bathroom standard for newly constructed housing, which has long been evident in the single-family market, has clearly made its appearance in the Los Angeles market for multi-family housing as well.

Trends in Rents and Rent-To-Income Ratios

Of all of the questions addressed in this study, arguably the most significant from a policy standpoint is what has happened to average rents paid by the rent stabilized population during the period 1984-1987 when the CPI-based ceiling on rent increases has been in effect, and how these trends in rents have compared with contemporary changes in tenant income. This section addresses these key questions of fact. It also presents the first comparison of rents and rent-to-income ratios among stabilized and unstabilized households, respectively. Because only the 1987 surveys included unstabilized Los Angeles households, this comparison can be made for that year alone.

In reviewing these findings, the reader will need to keep in mind the distinction between contract rent and gross rent. Contract rent, as used herein, is the amount of money paid by the tenant household to the landlord, whether solely for rental of space or for that plus provision of utilities.¹ Most tenant

¹"Utilities," as used here, means electricity and gas only.

households in Los Angeles -- 82% of those in stabilized units in 1987 -- pay their own utilities directly. However, the remainder do not, and frequently have no way of knowing how much of their rent payment is used to defray utility costs. Thus, the contract rents recorded for these households are biased upward by the inclusion of an unknown amount beyond the sheer rental of space, and there is no way of correcting for this bias using data collected solely from tenants.

Since the tenant households that pay utilities directly do know the amount of these payments, however, it is possible to ascertain and add their utility payments to their contract rents. This results in a figure that is comparable to the contract rents of households who do not pay utilities directly. This figure is conventionally referred to as gross rent, and is so designated herein, as it was in the 1985 study. Gross rent, therefore, means rent plus utilities, not simply the amount paid for rental of space. For the minority of households who pay for their utilities through their rent payments, gross rent and contract rent are equal. For the majority of households who pay utilities directly, gross rent is larger than contract rent. For most but not all purposes, the gross rent figure is the more accurate, and is used in most of the comparisons drawn below.

Chart 3.3 on the following page displays the survey findings with respect to the behavior of rents and rent-to-income ratios in the stabilized population in 1984 and 1987, and in the unstabilized population in 1987 only.

CHART 3.3

TRENDS IN MONTHLY RENTS AND ANNUAL RENT-TO-INCOME RATIOS IN THE RENT STABILIZED POPULATION, 1984-1987, COMPARED WITH THE SITUATION OF THE UNSTABILIZED POPULATION IN 1987

	<u>1984 Survey</u>	<u>1987 Survey</u>	
	<u>Rent Stabilized Units</u>	<u>Rent Stabilized Units</u>	<u>Unstabilized Units</u>
Average Gross Rents* Per Month	\$444	\$525	\$675
Average Annual Household Income	\$23,634	\$25,931	\$30,753
Average Gross Rent-to-Income Ratio	28.5%	29.2%	30.6%
Distribution of Gross Rent- to-Income Ratios Within Each Household Population			
Less than 20%	35.2%	34.1%	23.2%
20% to 29.9%	27.3	27.6	35.6
30% to 39.9%	17.5	15.6	20.1
More than 40%	19.9	22.7	21.1
	100.0%	100.0%	100.0%

* The comparable contract rent figures were \$408 for rent stabilized households in 1984, \$492 for stabilized households in 1987, and \$639 in unstabilized households in 1987.

The dollar change in average monthly gross rent paid by the stabilized population which is shown in Chart 3.3 works out to an average annual increase of 5.7% per year for the three years ending November 1987.¹ This compares to a compound annual increase of 10.9% during the years 1977-84.² That is to say, the CPI-based ceiling on increases in the rent that could be charged to a tenant household that had been in its unit for at least a year, a ceiling which averaged 4.5% per year, was associated with an actual compound average increase of 5.7% charged to all households in the stabilized stock. In contrast, the flat 7% ceiling on increases to such tenants (plus the initial rent freeze in 1978 before the flat ceiling went into effect) was associated with a compound average increase of 10.9% per year during the previous seven years. The difference between the ceiling on increases for non-vacated apartments and the actual average increase is accounted for, of course, by the non-regulated increases that are permitted in the rents charged to incoming tenants moving into vacated units.

Note that the fact that a particular ceiling-setting regime was associated with a particular pattern of actual average rent increases does not prove that the change in method of setting the ceiling was solely responsible for the difference in actual

¹This was the compound average. The simple average increase for the three years was 6.1%. This figure is used below for comparisons with other simple averages.

²HR&A, The Rent Stabilization System, op. cit, p. 12. The average gross rent in the stabilized population in 1977 was \$205.

average increases charged. The factor that determines the difference between the ceiling on rent increases to non-vacating tenants and average actual rent increases to all tenants, including new ones, is the overall market for rental housing in the City, as expressed in the unregulated rents that are charged to new tenant households.¹ As we have seen in the previous Chapter, many forces influence the behavior of that market. And, primary market factors -- e.g., interest rates, tenant mobility, rates of new rental housing construction -- have behaved very differently during the past three years as compared to the previous seven. Thus, although the CPI-based ceiling has been associated with markedly lower average annual increases, this fact cannot be properly attributed to the new ceiling-setting method alone.²

It is impossible to sort out the precise degree of influence upon overall average rents in the stabilized units that was exerted by the various other market influences from that which was exerted by the CPI-based ceiling on rent increases for non-

¹It should also be borne in mind that gross rents include gas and electricity charges, so that year-to-year differences in gross rents may be affected by changes in the rates charged for these utilities that may or may not track contemporaneous changes in space rental charges. This study does not address the impact of utility charges, taken alone, on the behavior of average gross rents.

²Obviously, the CPI-based method is keyed to another key market factor: inflation. If the 1984-87 period had witnessed the inflation rates that occurred during most of the 1977-84 interval, the CPI-based formula would have permitted substantially higher rent increases to non-vacating tenants during the past three years.

vacated units. What can be inferred from the data is that the ceiling probably did have a moderately suppressive effect on increases in the rents charged to non-vacating tenants (the average amount of this impact is estimated later), but that the differential between such an increase and the unregulated rent that a newly-arriving tenant would be willing to pay for the same unit narrowed significantly as against the corresponding gap in most of the years preceding 1985. Put another way, the CPI-based ceiling probably had moderate average impact, but, even though it was much lower than the prior ceiling, there was substantially less market pressure against it in the later period than there had been against its predecessor. This was evidenced by the fact that the difference between the actual overall average rent increase and the ceiling declined during 1984-87 despite the fact that the increase in the propensity of tenants to move meant that a higher proportion of them were required to pay unregulated rents.¹

The data in the Chart also amply confirm that the average unit in the newer, unstabilized multi-family stock was substantially more expensive than its stabilized counterpart. The difference in the averages was \$150 per month, or 29% more than the rent charged for the average stabilized unit. This cost differential is significant, but, it must be remembered, so are the differences between the physical characteristics of the two

¹It will be recalled from Chapter 2 that 55% of the households in the stabilized stock moved during 1984-87, as against only 45% in 1981-84.

types of units whose average cost is being compared. The unstabilized stock is not only (by definition) newer, but, as shown above, its units frequently have more bedrooms and/or multiple bathroom facilities. Consequently, the data do not indicate that the average consumer of unstabilized housing was paying 29% more for the same item than the average consumer of stabilized housing; rather, the message was that the average unit of each type of housing commanded a price that differed by that margin. This difference was presumably in part caused by the fact that one type was regulated and the other was not, and in part by differences in value between the two types as perceived by the consumer.¹

Turning to the behavior of rent-to-income ratios during 1984-87, we have already seen that the average income of rent stabilized households rose a bit more slowly than inflation during this period, causing an average loss of real income of about 3%. The preceding paragraphs make it clear that average

¹It should also be kept in mind that the average rent charged for each type of housing reflected a diverse amalgam of quite different individual circumstances. On the stabilized side, the average reflected a non-trivial number of units that have never been vacated since 1978, and therefore have not had their free-market rents tested in a decade, along with many units (55% of the entire stabilized stock) that have changed hands within the past three years, so that their rents have recently been set at unregulated levels, and may have been so reset several times over the course of the decade. The average rent for the unstabilized stock, on the other hand, reflected very new housing, plus housing that was nearly a decade old in 1987, plus at least some housing of all ages in between. Because of this diversity on each side, the difference in the overall average rent paid for each housing type should not be expected to predict the cost differential between units in any given set of buildings.

stabilized rents have increased a bit faster than inflation. It follows that the average proportion of income that stabilized households have been required to pay as rent rose during the period. As Chart 3.3 shows, the increase was from 28.5% in 1984 to 29.2% in 1987, or seven-tenths of one percent. This means that while the purchasing power represented by their average total income was dropping by about 3%, the share of that purchasing power that the average stabilized household paid in gross rent increased in size by about 3%.¹ Put another way, average household income in the stabilized population rose at a slower rate (3.2% per year) than did average stabilized gross rent (6.1% per year), thereby raising the average rent-to-income ratio.

This growth in the proportion of income paid in stabilized rent proceeded at about the same pace in 1984-87 as it had over the period 1977-84.² In the earlier period, the average stabilized rent rose from 26.9% to 28.5% of tenant household income, an increase of 1.6% of that income, or an average increase of a bit

¹Note that these percentages are applied to quite different bases. The first is a share of total household income; the second is a share of the portion of that income, which was less than one-third, that was paid in rent (i.e., a change of seven-tenths of one percent from a base of 28.5%). Thus, although both figures turned out to round to 3%, one represents 3% of about \$20,000, while the other denotes 3% of less than \$6,000. The two percentages may not, therefore, be added or otherwise treated as equivalents.

²Again, it should be noted that the 1977-84 period featured an economic roller coaster of unprecedented dimensions. Thus, although the average rate of growth in the rent-to-income ratio for that period works out to about the same rate as was recorded by 1984-87, the reader should not assume that this average held for any single year in the earlier seven-year period.

more than two-tenths of one percent per year for each of the seven years.¹ This compares to the increase of seven-tenths of one percent during the three years 1984-87, which also represents an average annual increase of a bit more than two-tenths of one percent. The implication is that the relation between the growth in average stabilized rent and the increase in average income of rent stabilized households has held reasonably constant if looked at over the past decade as a whole, and seems not to have been greatly affected by the 1985 change in the ceiling-setting formula. The evidence suggests that throughout the entire history of rent stabilization in Los Angeles, the average proportion of tenant household income paid in stabilized rent has grown at what works out to be, in retrospect, a long-term average rate of just over two-tenths of one percent (actually, .23%) of income per year.

This again does not necessarily mean that either the old or the new ceiling-setting method used in rent stabilization was or is the primary force that has established or maintained this long-term relation between income growth and the growth in stabilized housing costs. The ceiling-setting method presumably has virtually no impact on average household income growth, and we have seen that its influence on the growth of average stabilized rent depends heavily upon surrounding market conditions. Under some circumstances either method could exert strong resistance against market forces, and both may in fact have done so at some

¹HR&A, The Rent Stabilization System, op. cit., Exhibit 2.2.

point in their respective periods of application. All that can be said with certainty here is that the relation between household income growth and the growth of average stabilized rent seemed to be about the same in the last three years as in the previous seven, so that the average rate of annual change over the decade remained at a reasonably constant level of increase in the rent-to-income ratio for stabilized households.

It is also of interest that, despite a decade of increase in the average proportion of household income paid in stabilized rent, that average proportion remained in what is usually considered the "affordable" range in 1987. In the end, affordability is almost always in the eye of the beholding consumer. Whatever standards may be set by others, it is invariably true that some element -- and often quite a large element -- of the consumer market for any commodity or service is comprised of people who buy the item at a price above what they and others believe they can afford. In other words, they suffer what they regard as an undesirable and perhaps unreasonable intrusion upon other uses of their limited resources in order to pay the price asked for the commodity or service in question because they assign it a higher priority than the competing uses. Housing is a prime example of this phenomenon, as evidenced by the previously reported fact

that nearly four of every 10 rent stabilized households in Los Angeles paid higher rents in 1987 (and in 1984¹) than the most popular affordability standard would suggest they could afford.

In spite of their subjectivity, however, affordability standards are useful if only as benchmarks by which to measure changes in the propensity of housing costs to displace consumer spending for other purposes. Although several such standards have been widely used in the housing field, and there is a lively technical debate about the introduction of still others, the standard that has usually been employed by Federal and other governmental authorities holds that rental housing is affordable only if gross rent is equal to or less than 30% of household income.² According to this standard, the above discussion makes it clear that the average share of income consumed by stabilized rent in Los Angeles remains affordable, as it has been at all times since before the introduction of rent stabilization. But the long-term trend in which stabilized rents have risen a bit faster than the growth in income means that, at a current average of 29.2% of income, stabilized rent has drawn quite close to the

¹In 1977, the proportion over the standard was about 34%, or well over three in every 10 households.

²The principal competing standard has been 25% of household income, which remains popular in some professional circles. On the other hand, there has been some recent expression of sentiment to the effect that 40% represents a more genuine reflection of the relative value and cost of housing in today's economy. The reader is free to select his/her own definition of affordability, and to use the figures presented herein to document whatever case for or against the degree of affordability represented by current Los Angeles rents that that definition implies.

standard. Assuming no change in the trend that has been established during the past decade, and that this particular affordability standard continues to be accepted in the interim, history gives reason to expect that the affordability threshold will be crossed by average stabilized rent at the outset of the 1990s.

The figures in Chart 3.3 which group households according to four categories of rent-to-income ratios do not suggest any dramatic change in the distribution of affordability within the rent stabilized population during the past three years. As in 1984, the survey indicated that about two-thirds of that population paid 20% or more of their incomes in rent, and well over one-third paid more than 30%. These proportions were nearly identical to those recorded in 1984. Likewise, approximately one-third of the population continued to consist of households which paid less than 20% of their incomes in rent, a group which the 1985 study characterized as largely comprised of "unintended beneficiaries" of the stabilization program. The numbers provide some support for the belief that there may have been a significant increase in the proportion of households that paid more than 40% of income in rent, and a nearly corresponding decrease in the number that paid 30-40%, but further research is required before this change can be confirmed.

Shifting focus to the unstabilized stock, where only 1987 figures are available, it is significant that average rent in this unregulated stock also worked out to be quite close (at

30.6%) to the 30% affordability standard. This suggests that the advent of rent stabilization has not put such strong pressure on owners of both old and new buildings to increase rents in the latter, in order to offset shortfalls in the former, that rents for units constructed over the past decade have been driven high above the affordability range. This inference appears to be generally valid. However, as will be documented later in some detail, this overall average rent-to-income ratio for unstabilized units is a bit misleading because of the skewing effect of households with annual incomes of more than \$40,000.

For unstabilized households with incomes between \$20,000 and \$30,000, for example, the ratio was 32.5%. Also, because of the great difference in the respective shares of households which fell into the various income categories in the two stocks, the differential between the average ratios within individual income (and other) subgroups was almost always larger than the difference between the overall average ratio for stabilized households and that for unstabilized ones.¹ Thus, for example, within the subset of households in each stock with incomes between \$20,000 and \$30,000, the average rent-to-income ratio of stabilized households was 27% in 1987, or 5.5 percentage points below the aforementioned 32.5% of income that was paid by unstabilized

¹If one controls statistically for the differences in the share of households that fall within each income groupings as between the two types of housing stock, the average gross rent-to-income ratio of the unstabilized stock registers as 4.5% higher than the average ratio in the rent stabilized stock. This difference is statistically significant at the 99% level of confidence.

households in the same income range. Therefore it is not correct to assume that the rent-to-income situations of most subgroups of unstabilized households were comparable to those of subgroups with similar demographic characteristics in the stabilized population. In general, the stabilized subgroup paid a significantly smaller proportion of its income in rent. This follows from the fact, reflected in the figures in Chart 3.3, that the average rent charged in 1987 for unstabilized units was 29% higher than the average for stabilized units, while the average income of the unstabilized tenant households was only 19% higher than the average for the stabilized households.

Nevertheless, the rent-to-income distribution ratios displayed in Chart 3.3 show that only a slightly larger share (41% vs. 38%) of unstabilized households were paying unaffordable rents in 1987 according to the 30% affordability standard. The major difference between the two distribution profiles lay in the fact that unstabilized households included a substantially smaller share (23% vs. 34%) of households paying less than 20% of their income in rent, and larger proportion (35% vs. 28%) paying between 20% and 30%. In other words, despite their higher average income, relatively fewer unstabilized households paid a far lower proportion in rent than they could afford than was true of stabilized households.

Chart 3.4 on the following two pages breaks down both rent behavior and the behavior of rent-to-income characteristics by the principal demographic characteristics of tenant households, both stabilized and unstabilized.

CHART 3.4

TRENDS IN RENTS AND RENT-TO-INCOME RATIOS IN LOS ANGELES RENT STABILIZED HOUSEHOLDS, 1984-87, AND UNSTABILIZED HOUSEHOLD SITUATIONS IN 1987

HOUSEHOLD CHARACTER- ISTICS	Gross Rents			Gross Rent-to-Income Ratios		
	1984	1987		1984	1987	
	Rent Stab. Units	Rent Stab. Units	Unstab. Units	Rent Stab. Units	Rent Stab. Units	Unstab. Units
<u>Age of Household Head</u>						
<30 years	\$460	\$516	\$640	30.1%	30.7%	32.0%
30 to 62	447	529	668	26.7	27.8	29.5
>62 years	379	436	501	33.4	33.5	42.1*
<u>Household Size</u>						
One	\$384	\$462	\$617	28.4%	28.2%	29.7%
Two	485	560	749	27.2	27.4	29.3
Three or Four	485	539	654	29.0	30.4	32.3
Five or More	434	545	609	32.1	34.7	31.9

Household Income

Under \$10,000	\$393	\$448	\$523	51.9%	57.7%	67.7%*
10,000-19,999	405	450	531	37.0	39.3	44.0
20,000-29,999	448	519	640	24.5	27.0	32.5
30,000-39,999	507	588	715	18.8	21.7	26.2
Over \$40,000	563	666	824	15.3	15.4	19.3

Race/Ethnicity of Household Head

White	\$489	\$577	\$762	27.9%	27.5%	29.8%
Black	402	483	592	30.2	27.3	23.9*
Hispanic	371	462	510	29.1	33.8	33.4
Other	453	538	709	27.2	30.3	30.8

Length of Tenant Tenure (Years in Unit)

Less than 1	\$496	\$601	\$712	28.7%	32.9%	33.4%
1-2.99 years	495	581	701	30.6	31.6	30.5
3 - 5.99 years	440	520	692	27.2	28.5	24.5
Over 6 years	371	439	553	26.7	25.3	31.1*

* Number of observations is less than 10

With respect to the rent stabilized population, the data reported in Chart 3.4 suggest continuation of most of the trends that were visible in the 1985 study of the effects of the Rent Stabilization Ordinance. In the case of age of household head, for example, the 1987 figures indicated that households headed by people who had passed their 62nd birthday continued to average by far the lowest stabilized gross dollar rent (\$436 per month), but also continued, nevertheless, to pay the largest average share of their incomes (33.5%) in rent. This pattern has been a standard feature of this distribution throughout the decade of rent stabilization. Similarly, in the case of household size, the 1987 survey again demonstrated that the bulk of the growth in rent-to-income ratio was in households containing three or more persons, particularly in those with five or more. It should be noted, however, that, for the first time in the decade for which data of this kind exist, the 1987 survey found that the average stabilized dollar rent paid by a household of five or more was higher than the average rent paid by a 3-4-person household. This probably mainly reflected increased mobility among larger tenant households, creating greater demand pressure on the prices charged to new tenants for larger units.¹

¹Note, however, that the average dollar gross rent paid by stabilized households of five persons or more was still lower than the average paid by two-person households, which repeats a phenomenon that has emerged in every survey since 1977. It presumably reflects both lower mobility in two-person households and important differences in the average physical and locational quality of the one-bedroom units in the stabilized stock, as compared to those capable of housing a family of five or more.

On the household income front, while the 1987 survey of stabilized households confirmed that the tenants hardest hit by increases in rent-to-income ratios were the poor (i.e. those with less than \$10,000 in income), it indicated virtually no growth in the ratio of households at the upper end of the income distribution (i.e., those with more than \$40,000 in annual income). This represented a change from the 1977-84 pattern, in which the average ratio in the most affluent of the income categories had risen by about two-thirds (from 8.9% to 15.3%) in the course of those seven years. Growth in the average ratio of households with incomes between \$20,000 and \$40,000 seemed to be roughly in line with the 1977-84 experience. It is a sobering revelation, from a social policy standpoint, however, that rent stabilized households which earned less than \$10,000 in 1987 paid an average of about 58% of their money incomes in rent, as compared to about 37% in 1977.¹

The racial/ethnic breakdown of trends in the rent stabilized population are also striking, although once again they largely confirmed trends which had been evident in the 1977-84 data. While households headed by all four racial/ethnic groups tracked

¹The reader should note that households in this income category (i) make up only about 11% of the stabilized household population (down from 14% in 1984); and (ii) usually have access to a variety of types of non-monetary, in-kind public benefits (e.g., MediCare, MediCal, Food Stamps) which supplement their money income and thereby make their rent-to-income ratios somewhat less accurate indicators. Nevertheless, an average ratio 58% means that many such households paid 60%, 70% or an even higher proportion of their incomes solely for housing. This is a genuine statistical footprint of poverty.

by the study paid larger average dollar gross rents in 1987 than they had in 1984, the rent-to-income ratios of Black-headed households actually declined during the period, while White-headed households remained static and the ratios of households headed by Hispanics and Others (largely Asians) surged ahead. In other words, while members of all four groups paid more rent, all of the increase in average rent-to-income ratios over the three years was accounted for by Hispanic- and (primarily) Asian-headed households.¹

Virtual stasis of the average rent-to-income ratio of stabilized households headed by Whites has now been in effect for the entire decade of rent stabilization. Their average ratio was 27.9% of income in 1977, it was 27.9% again in 1984, and these figures show that it was a statistically indistinguishable 27.5% in 1987.² This is particularly noteworthy in view of the fact that the overall average ratio for all stabilized households rose by 2.3% of total income (or nearly 9% of the former housing share of income) over the decade. Again, this average stability among White-headed households primarily reflected the fact that the largest share of those of this description who lived in the rent

¹Note that this does not imply that there were no households headed by Whites which experienced an increase in their rent-to-income ratios during 1984-87. There were a considerable number of such households. However, as in previous years, when all households with this experience were averaged in with all other White-headed households in the sample, the average ratio remained essentially unchanged from the figure that has appeared at every point that the ratio has been observed.

²The apparent change between the 1984 and 1987 samplings is too small to have any statistical significance.

stabilized population tended to be older, smaller and more likely not to vacate their units than were households headed by persons of other races/ethnicities.

The visible decline in the average rent-to-income ratio of households headed by Blacks between 1984 and 1987 was a departure from a previous history in which their ratios had also been virtually static between 1977 and 1984.¹ The drop in the share of income devoted to rent that was recorded during the last three years, a fall of 2.9% of total household income, was the first major shift in these ratios ever registered for Black households.

In the case of members of other minority groups, however, the trend was in the opposite direction, as it has been since data of this kind have been collected. The average increase of 4.7% of household income devoted to rent that was recorded for Hispanic households represented a faster annual rate of increase in the ratio than had been exhibited in 1977-84. The 3.1% rise registered by Asians and Other minorities was approximately in line with the growth rate of the ratio that occurred during those years. During the 10 years of rent stabilization taken as a whole, the share of income devoted to payment of stabilized rent has increased by between 9% and 10% of the average income of households headed by members of these minority groups.

¹The 1985 study reported that the gross rent-to-income ratios of households headed by Blacks had increased by 1% of total income (from 29.2% to 30.2%) between 1977 and 1984. HR&A, The Rent Stabilization System, op. cit., Exhibit 2-3.

When stabilized tenant households were subdivided according to the length of time that they had held their units, the behavioral patterns of rents and rent-to-income ratios were once again familiar. As would be expected from the fact that the rents charged to new tenants have always been unregulated, the highest average rent was paid by households that had occupied their units for less than one year. And, average rent declined in each successive category of longer tenure, falling from \$601 per month for new tenants to \$439 per month for those who had occupied their units for more than six years. The average rent paid by new tenants was 37% higher than the average paid by the longest-tenured. This was a bit more than the 34% margin that was registered in 1984, and far higher than the 12% recorded at the outset of rent regulation in 1977.¹ This confirmed that one of the key findings of the 1985 study -- that the form of rent regulation adopted in Los Angeles tends to increase the differences in rent experienced between tenants over time, and that the most important differentiating factor is length of tenure -- remained true as of 1987.

The same trend continuation was suggested in the behavior of average rent-to-income ratios of the tenure subgroups of the stabilized population. As in 1977-84, the only subgroup whose

¹The 1977 figures showed a very narrow total range of average rents charged to the tenure subgroups. The average for new tenants was then \$212 per month, as compared with \$189 for the longest-tenured.

average ratio dropped was the longest-tenured; the ratios for all other subgroups rose, though at rates that varied considerably. By far the largest increase in the average share of income devoted to rent was registered by the new tenants, whose ratio jumped by an impressive 4.2% of their total income. No other tenure subgroup experienced a rise of anything like this scale, the second largest increase being only 1.3% of income. The implication was that a good share of the new tenant mobility evidenced in the 1987 survey consisted of households that elected to move to new apartments despite the fact that they were required to pay a substantially higher share of their incomes in order to do so.

In sum, the new evidence collected in late 1987 as to the distribution of rents and rent-to-income ratios experienced by rent stabilized households of various demographic descriptions suggests that most of the trends revealed in 1984 continued to hold true, although some were intensified. As in 1984:

- * Households headed by elderly persons showed the lowest average rents, but also the largest average share of income paid in rent. However, large as it was, this average share continued to drop, while the shares of all other age subgroups continued to rise.

- * Most of the growth in average rent-to-income ratio occurred in households containing three or more persons.

- * The share of income paid in rent by households that earned less than \$10,000 per year continued to soar, and noticeable increases occurred in most other income subgroups.

- * The average increase in rent-to-income ratio was centered in Hispanic and Asian and Other minority-headed households, not in households headed by Whites or by Blacks. The aver-

age rent-to-income ratio of Whites continued essentially unchanged, as it has been over the full decade of rent stabilization.

- * Length of tenure continued to be inversely related to average rent paid, and the margin between the average paid by new tenants and that of the longest-tenured subgroup continued to grow.

In addition to these continuations of 1984 trends, however, two new directions of change emerged in the 1984-87 data on rent stabilized households:

- * The average rent-to-income ratio of households with annual incomes of more than \$40,000 stopped rising, after having risen sharply during 1977-84. This halt occurred despite the fact that the average rent paid by these households increased significantly between 1984 and 1987.¹

- * The average rent-to-income ratio of households headed by Blacks dropped for the first time in 1984-87, after having increased very slowly over the previous seven years.

It remains to be seen whether these shifts in direction will demonstrate the staying power of the larger number of trends established in 1977-84 which continued through 1987.

Shifting focus to what the data in Chart 3.4 indicate regarding the unstabilized households who occupied relatively new housing in 1987, a few interesting points of comparison and contrast with the stabilized population emerged:

- * The sample of unstabilized households indicated that there were very few elderly or poor households in the unstabilized multi-family stock.

- * As in the stabilized population, two-person households paid the largest average rents, but those with three or more persons had the highest average rent-to-income ratios.

¹The increase in average stabilized rent paid by households in this income category between 1984 and 1987 was 19%.

* Only the households in the unstabilized stock with annual incomes of more than \$30,000 had rent-to-income ratios below the Federal affordability threshold, while \$20,000 was the affordability dividing line for stabilized households.

* As was true of stabilized households, only unstabilized households headed by Whites and Blacks showed rent-to-income ratios below the affordability threshold.

* The inverse relation between length of tenure and average rent paid was just as true of the unstabilized population as of the stabilized, and the same relation probably held true in both populations with respect to rent-to-income ratios as well.¹

As to the last listed of these comparisons, it should be remembered that the unstabilized stock sampled here consists entirely of units built during the last 10 years. Since no rent stabilization regime has operated here to create an advantage for households who stay in their units for long periods, the considerable differential between tenure subgroups in the unstabilized sample must be attributed to other causes. One of these is clearly the premium that many renters apparently attached to newness, even as compared to other units that were also relatively new. Other differentiating factors presumably include changing land costs, financing charges, the price of building materials, and the cost of skilled design talent and construction labor. However, some of these factors, particularly financing costs, would seem to have been more favorable in recent years than in the years in which the units were constructed that house

¹As noted on the Chart, the number of households in the unstabilized sample which had been in their units for more than six years was too small to generate reliable data. This is hardly surprising, given the relatively low rate of new construction of multi-family housing in the early 1980s. Such a household would need to have moved into a unit by 1981 that had been constructed during 1978-81. The average rent-to-income recorded for this tenure subgroup is, therefore, not used in this discussion.

the households which have been in place for more than six years. Nevertheless, the average rent of an unstabilized unit for a new tenant in 1987 worked out to be 29% higher than the average rent paid by an unstabilized household that had been in its unit for six years or more. This may have been an artifact of the small number of tenants in the unstabilized sample who fit into the latter category, but, if not, it is a phenomenon difficult to explain. Further research on the unstabilized population will be required in order either to disprove or to explain it.

Tenant Payment of Special Fees for Services and Capital Improvement Surcharges

Very few tenants contacted in the 1987 survey reported paying any "special fees" to building owners on top of stabilized rents for extra services provided, such as for the use of laundry rooms or commons areas or swimming pools. Whereas 9% of the 1984 respondents said their landlords had levied special fees for such services, only 5% reported that special fees were being charged in 1987.

The incidence of tenant payment of capital improvement surcharges on their rent, on the other hand, was about the same in the new survey. Eight percent of the 1987 respondents reported paying such surcharges, or slightly fewer than the 9% who did so in 1984. Of the households that reported paying such surcharge in 1987, only 20% were able to provide the exact amount. (This mirrored the response from surcharge-paying households in

1984, when 18% were able to provide the exact amount of the surcharge.) Thus, the sample of surcharge information collected reflects the situation of only one out of five households that reported paying such a surcharge. As in 1984, there is no way of knowing whether this sample of tenants is systematically biased in some way other than according to the level of the detail of the memory of the respondent, so the reliability of the data cannot be verified. For whatever it is worth, however, the average surcharge on monthly rent paid for capital improvements that was reported in 1987 was \$11.06, or about 2% of contract rent. This compares to an average reported surcharge of \$21, or 6% of contract rent, in 1984.

Actual and Allowed Rent Increases

Because of Council concern about the level and effectiveness of enforcement of the Rent Stabilization Ordinance, the 1985 study made some general measurements of the degree to which building owners were strictly observing the limitations of the Ordinance with respect to allowable rent increases. These measurements were designed as cross-checks on the data generated in the course of the City's enforcement procedures, which were and are activated by tenant complaints about practices in individual buildings. Because the administration of rent stabilization was arguably made more complex when the CPI-based ceiling setting method replaced the flat 7% ceiling on increases in 1985, these

measurements were repeated in the 1987 surveys in order to see whether there had been any appreciable change in the evidence that most building owners were complying with the Ordinance.

The 1987 evidence indicates that the CPI-based method did not result in any significant change in the high level of apartment building owner compliance that was found in 1984.

The 1984 data showed tenant-reported average 1984 contract rents as often near but in no case above the allowable maximum level for the tenants in all tenure subgroups.¹ That is, in no tenure class did the average rent charged exceed the average estimated maximum that could legally be charged when the applicable ceiling on increases was applied in light of the rent and tenure history supplied by the tenant. This is not to say that there were no tenants who reported being charged rents that seemed to be above the legal maximum. About 22% of the 1984 respondents did report rents more than 10% above the estimated maximum, just as about 24% reported rents that were less than 90% of what the landlord was estimated to be permitted to charge.

¹It will be noted that the standard of measurement used here is contract rents, not the gross rent figure previously used to discuss rents and rent-to-income ratios. This reflects the fact that the Ordinance regulates contract rents, not gross rents. That is, the ceiling on increases is stated in terms of a percentage of the rent paid by the tenant to the landlord, not this rent plus the separate payments that most tenants make for gas and electricity. (A special add-on of 1% is permitted to landlords who provide either gas or electricity within the rental charge, or 2% for those who provide both.) Since the ceiling operates on contract rents, the proper measurement of the degree of general landlord compliance is whether these rents have, on average, stayed within the limits prescribed by law.

This general pattern held true regardless of the length of tenant tenure. Nevertheless, since the overall average rent charged computed to 1.5% less than the estimated allowable maximum and the average for each tenure subgroup also fell below the maximum average for that subgroup, the 1985 Report concluded that the evidence suggested that most landlords were complying with the Ordinance.

This conclusion still seems to hold in the light of the 1987 data. Here once again, maximum allowable rents were calculated based on the reported initial rents which tenants recalled that they had paid when they first moved into their units.¹ The maximum allowable contract rent for 1987 was then estimated using the ceilings on increases that were specified in the RSO from that date forward.² The results of comparing the averages of these estimated maximum average with the average actual rents reported by the same tenants are shown below in Chart 3.5.

¹Most but not all tenant respondents could recall the rent that they had first paid upon moving in. In both the 1984 and 1987 surveys the proportion of those who said they could recall turned out to be 75%. The data base for all calculations of maximum allowable rents is confined to the responses and experience of this majority of tenants who said that they could recall the amounts that they were originally charged.

²The amount of the maximum allowable rent increases was calculated using the 7% annual adjustment prior to June 1985, and the CPI-based maximum increases thereafter. Then, an additional increase of 1% for each service was added for gas and electrical services covered by the rent and paid by the landlord.

CHART 3.5

COMPARISON OF INITIAL, CURRENT AND ESTIMATED LEGAL MAXIMUM AVERAGE STABILIZED MONTHLY RENTS, 1984 AND 1987 SURVEYS, BY LENGTH OF TENURE IN UNIT*

<u>Length of Tenure</u>	<u>1984 Survey</u>			<u>1987 Survey</u>		
	<u>Initl. Rent</u>	<u>Currt. Rent</u>	<u>Max. Rent.</u>	<u>Initl. Rent</u>	<u>Currt. Rent</u>	<u>Max. Rent</u>
Less than 1 year	\$463	\$463	Unreg.	\$573	\$573	Unreg.
1 - 2 Years	417	455	460	517	\$547	\$551
3 - 5 Years	306	390	400	412	484	498
6 or More Years	220	336	336	265	406	446
<u>Additional Detail Collected Only in 1987</u>						
6 - 8 Years	-	-	-	327	413	497
9 or More Years	-	-	-	225	402	414

 * The same proportion of respondents in each survey, namely 75%, said that they were able to recall the initial rent that they had been charged when they first moved into their units. These figures are based on the rent reported by these tenants. Also, please note that the year in which the "initial rent" was paid varied from tenant to tenant, so that the average rent paid for that year does not refer to any single calendar year.

The Chart confirms that 1987 average rents in every tenure category -- including some new, longer-tenured ones for which separable data were collected for the first time in 1987 -- were lower than the averages that were estimated to result if the maximum allowable rent increase had been charged. Once again, a non-trivial number of tenants reported rents that were higher than the estimated maximum. Indeed, this contingent increased in size to 33% from the 22% who reported rents more than 10% above the estimated maximum in 1984, while the proportion of 1987 tenants who reported rents more than 10% below the maximum fell

to 10% from the 24% that was recorded in 1984.¹ The increase in the share of tenants reporting rents that seem to be above the legal maximum may reflect some increase in landlord uncertainty about what the new ceiling was in a given year, once it changed from the flat 7% that prevailed until 1985. In any case, the fact that 1987 average rents continued to fall below the maximum average in every tenure category suggests that landlord compliance with the Ordinance continued to be the rule.

Another means of evaluating landlord conformance with the law is to review the number of rent increases reported by the tenant respondents, and the relation of those increases to the maximum rises permitted by the Ordinance. Both the 1984 and 1987 surveys asked tenant respondents how frequently their (contract) rents had been raised and whether such increases were above, below or equal to the tenant's understanding of the maximum increase allowed by the Ordinance. Since there are no data on year-by-year changes in the rents charged to responding tenants, it is not possible to check the tenant's estimate of the maximum legally allowable increase against the actual increase that the tenant says was imposed. Thus, the data on this point reported by survey respondents must be understood as reflecting the tenant's

¹In addition, unlike the 1984 data, the 1987 survey results suggested some relation between length of tenure and propensity to report rents that were either significantly higher or lower than the estimated legal maximum. The longer the tenure of the respondent in his/her unit, the more likely that the rent reported would fall well above or below the estimated legal maximum. This may reflect that the 20% of the stabilized population who have been in place longest must now recall rents charged them a decade ago.

own calculation of the allowable increase, not that of the landlord or of a disinterested observer. With this caveat, the tenant responses are summarized in Chart 3.6 on the following page.

CHART 3.6

TENANT-REPORTED FREQUENCY AND AMOUNT OF RENT INCREASES IN RENT STABILIZED UNITS: 1984 AND 1987 TENANT SURVEYS

	Length of Tenure					
	1 - 2 Years		3 - 5 Years		6 or More	
	1984 Surv.	1987 Surv.	1984 Surv.	1987 Surv.	1984 Surv.	1987 Surv.
<u>Frequency of Rent Increase</u>						
Never	32%	40%	13%	10%	4%	4%
Once a Year	51	47	53	64	69	80
More Than Once a Year	3	1	4	5	4	4
Less Than Once a Year	14	11	20	21	23	12
<u>Tenant's Report of Relation of Rent Increases to Legal Ceiling*</u>						
More Than the Maximum	3%	3%	3%	2%	4%	4%
Always the Maximum	83	63	85	68	86	77
Less Than the Maximum	6	9	5	11	5	3
Sometimes More/ Sometimes Less	3	5	4	6	4	7
Don't Know Maximum Allowed Increase	3	20	2	14	1	9

* The responses summarized below exclude (i) all tenants who responded that they did not know whether or not their units were subject to rent stabilization; (ii) all who responded that they had never experienced a rent increase. The "maximum" legal increase referred to is always the tenant's understanding of the amount of that increase, whether correct or incorrect. Totals may not add to 100% because of rounding.

The findings reported in Chart 3.6 seem to confirm the evidence of general landlord compliance reported earlier, though they also raise some question as to whether tenants have been able to keep up with the annual format of the CPI-based ceiling-setting method, as compared with the flat ceiling that was in force prior to 1985.

The Chart shows that tenant reports of landlords raising their rents more frequently than the once per year permitted by the Ordinance were at about the same minimal level in 1987 as in 1984. The same was true of reports of rent increases that exceeded the tenant's understanding of the legal maximum. In both of these respects, the data consistently indicated that at least 95% of all landlords were believed by their tenants to have complied with the terms of the Ordinance. The new phenomenon that did emerge in the 1987 survey was substantial elevation in the proportion of tenants, particularly those of relatively short tenure in their units, who knew that they were covered by rent stabilization but did not know the maximum allowable rent increase permitted by law. This presumably reflected the greater difficulty of keeping up with an annually adjusted ceiling than with one which cannot change from year to year¹.

¹The fact that the CPI-based ceiling has in fact always been 4% in every year save one since the change was made does not necessarily change this inference. If a tenant knows what the ceiling has been at some time in the past, but also knows that it is subject to periodic adjustment, it would be rational to respond that the current ceiling was unknown to him/her.

Estimating the Monetizable Benefits of Rent Stabilization

Estimating the volume and distribution of the benefits provided by rent stabilization is an extremely demanding task from a technical standpoint. Indeed, for reasons summarized below, estimating these items with great precision is beyond the capacity of this study and of all others yet performed in the United States and elsewhere. Nevertheless, it is possible to develop estimates that suggest the probable basic scale and distribution of these benefits. This section of the Chapter seeks to provide such estimates in the hope that they will be of use to City policy makers.

The benefit estimation problem begins with the fact that not all of the impacts of the Ordinance are directly translatable into dollar terms. This is particularly true of its bar to unfair eviction of tenants, but also extends to the impact of other provisions as well. Then, as emphasized throughout this Report, the number of factors other than rent regulation that influence the behavior of the multi-family housing market in Los Angeles is so large and has been so given to major fluctuation during the decade of stabilization that sorting out the pure impact of rent regulation can only yield approximations even where the benefits in question are monetizable. Accordingly, the intent here is to provide the most plausible approximations which

can be derived from the data, not to generate definitive estimates of the exact benefits received or the precise distribution of these benefits among socio-economic groups.

All measures of the benefits, as well as the costs, of stabilization seek to measure the difference between the situation that exists under stabilization and the situation that would exist if stabilization had never been introduced. This task becomes both more difficult and more error-prone the longer stabilization has been in effect. Though it is never possible to be certain what would have occurred in the absence of significant regulation of a market, it becomes less and less possible over time. As regulation becomes a perennial feature of the economic landscape, its existence not only affects the market elements that are directly regulated, but also indirectly influences the behavior of competing or substitutional markets. This gradually eliminates the capacity of conditions in surrounding unregulated markets to serve as accurate surrogates for what would have occurred in Los Angeles if the city had never adopted rent stabilization.

For this reason, this study employs just one of the two measures of benefits that were used in the earlier study of the impact of the Ordinance published in 1985. That study measured benefits by comparing contract rents against both an internal (to Los Angeles) projection of how they might have evolved from the base represented by their 1977 situation before stabilization was

enacted, and to average contract rents actually charged in six adjacent smaller cities which had never adopted rent regulation.¹ This study restricts the standard of comparison to an extended form of the internal projection from pre-stabilization (1977) conditions, which the 1985 study designated as "market rent." The financial benefits of rent stabilization are here defined as the difference between the average contract rents that stabilized Los Angeles tenant households actually paid in 1987 and the average contract rents that they would have paid, according to this projection, if the RSO had never been adopted.²

Of course, the benefit estimates contained in this Report are statistical averages, calculated from the experiences of many households. As such, they cannot be interpreted as representative of the experience of any specific household. A multiplicity of factors specific to the household and the rental housing unit it occupies determines the actual financial benefit realized by a that household.

¹This latter standard was referred to in the 1985 study as Imputed rent."

²Note that this definition assumes that the households would have purchased the same volume and quality of housing at either the market or the stabilized price. The fact that this would probably not always be true is just one of the many difficulties involved in any attempt to compare factual and non-factual circumstances. In this case, it is probable that some stabilized households have decided to purchase better housing than they would have without stabilization, while others have elected to stay in less commodious quarters because of the advantages that stabilization provides to non-movers. The analyst's hope is that these factors will at least approximately cancel each other out in the course of computing averages, but it can never be certain that they have actually done so.

The key to projecting the probable level of the market rents that would be charged in Los Angeles in 1987 if stabilization had not been adopted is the pattern of "tenure discounts." A tenure discount is the percentage of margin below the rents charged to new tenants that is charged to tenants who stay in their units for another year. Housing markets almost always exhibit a systematic pattern of such discounts, whether or not they are regulated, because, unless a particular tenant is unusually problematical in some way, there are financial and other advantages to a building owner to have the unit continually occupied by the current household. The method used to project market rents (i.e., the rents that would prevail absent rent stabilization) begins with the pattern of discounts to various tenure subgroups of tenants that was evidenced in 1977.

Since the Los Angeles rent stabilization regime permits building owners to adjust the rent charged for a stabilized unit to any level that the market will pay each time the unit becomes vacant, it is reasonable to suppose that the primary impact of stabilization is on the depth of the tenure discounts from that market level that it accords to households who elect to stay put. Households that move presumably receive no immediate benefit from rent stabilization -- indeed, as suggested by the 1985 study, they may pay premiums above what market rents would be without stabilization in order to finance the discounts that the law requires to be afforded to long-staying households. The real

measure of the benefits and costs of rent stabilization, therefore, lies in the change in the tenure discounts from what they would have been without stabilization, as expressed either in a margin of dollars which are not paid in rent by the long-stayers, or in a premium of additional dollars that are paid by short-tenured households.

Chart 3.7 on the following page shows the tenure discounts that emerge from analysis of data for 1977, 1984 and 1987.

CHART 3.7

AVERAGE TENURE DISCOUNTS ON RENTS CHARGED FOR PRE-STABILIZED UNITS IN 1977 AND FOR STABILIZED UNITS IN 1984 AND 1987

Percentage Discount Relative to Households With Tenure Of Less Than One Year ^a			
<u>Tenure</u>	<u>1977^b</u>	<u>1984</u>	<u>1987</u>
1 - 2 Years	-2.4%	0.8%	-0.6%
2 - 3 Years	-7.0**	-4.8	-11.1**
3 - 4 Years	-8.4**	-11.9**	-13.8**
4 - 5 Years	-8.4**	-14.6**	-17.9**
5 - 6 Years	-8.0**	-10.0*	-19.0**
6+ Years	-15.7**	-30.9**	-34.3**

^a By definition, households occupying their units for less than one year receive no tenure discount.

^b These 1977 tenure discounts were estimated in the 1985 Report from the 1977 Annual Housing Survey, which was conducted under Federal auspices and included data on Los Angeles as part of a national data base. See HR&A, The Rent Stabilization System, op. cit., p. 9 for a description of this data source.

* Statistically significant at the 95% confidence level.

** Statistically significant at the 99% confidence level.

The Chart leaves no doubt that average tenure discounts accorded to households that have been in place for two years or more have in fact deepened considerably in stabilized units during the period of rent stabilization. Whereas in 1977 a household with more than six years in its unit could have expected to pay a rent averaging about 16% less than the rent charged to a new tenant, in 1987 a household in a stabilized unit could expect to pay an average of about 34% less than a newcomer. In other words, the tenure discount for these longest-staying households more than doubled over the decade of stabilization. Meanwhile, however, the discount that could have been expected by households that had been in place for less than two years turned from a discount below market rent into a premium above that rent, charged in order that landlords with units of both kinds could make up some or all of the losses that would otherwise from the deeper discounts provided to longer stayers.

It is arguable, of course, whether all of this change in tenure discounts may be fairly attributed to rent stabilization. Just as many other factors were at work in shaping the general market for rental and owned housing and for construction thereof, various additional forces also doubtless influenced the discount offered to tenants who elected not to move. This presumption is reinforced by the evidence in the 1985 study that tenant mobility visibly decreased in the comparison cities without rent regulation. Nevertheless, the decline in these cities was not as

dramatic as in Los Angeles. And, rent stabilization is the only measurable force at work that was clearly and directly hinged on maintenance of tenure as the fact that determined whether or not the law would intervene in the market. For this reason, consistent with the approach taken in the 1985 study, the results reported here will assume that the benefits and costs that flowed from this change in tenure discounts can be solely attributed to the impact of rent stabilization.

The Chart documents the fact that tenure discounts continued to deepen between 1984 and 1987, indicating that average rents paid by new tenants continued to increase more rapidly than increases in the rents charged to staying tenants which were capped by the CPI-based ceiling. This, in turn, meant that the volume of overall average dollar benefits to tenants from rent stabilization also increased during this period. The estimated amount of this increase is shown in Chart 3.8 on the following page.

CHART 3.8

BENEFITS AND COSTS OF RENT STABILIZATION TO TENANTS, BY LENGTH OF TENURE IN UNITS, 1984 AND 1987

	Monthly Savings Based On:		As % of Average Monthly Income	
	Market Rents <u>1984</u>	Market Rents <u>1987</u>	<u>1984</u>	<u>1987</u>
All Households	\$18	\$24	.9%	1.1%
<u>By Length of Tenure</u>				
Less than 1 year	\$0	\$0	0%	0%
1 - 2 Years	-\$15	-\$11*	-.8%	-.5%
3 - 5 Years	\$11	\$29	.6%	1.3%
6+ Years	\$55	\$84	2.9%	3.8%
<u>Additional Detail Collected only in 1987</u>				
6 - 8 Years	--	\$64	--	2.7%
9+ Years	--	\$94	--	4.6%

* The difference between this estimate and zero tested as not statistically significant at the 95% confidence level. The corresponding estimate for 1984 did test as significant at the 99% confidence level. A negative figure indicates that rent stabilization resulted in a net cost to tenants in this tenure subgroup.

[NOTE: The estimates in this Chart were derived from the responses of only those respondents who provided complete information on all of the variables used in the benefit calculation, including information on the size and relative quality of the unit that they occupied. This body of tenants varied slightly from the overall sample.]

The basic message implied by the data reported in Chart 3.8 seemed to be that the effects of rent stabilization that were detected to have occurred during the period 1977-1984 seemed to continue approximately apace during 1984-87. Overall, the average monthly benefit rose from \$18 to \$24, an increase of one-third, but from a relatively modest base in terms of share of overall average tenant household income. Nevertheless, the data suggest that total savings from rent stabilization did exceed 1% of overall household income for the first time in 1987. As a percentage of monthly rent paid, overall average benefits increased from 4.4% in 1984 to 5.3% in 1987.

As always, the prime beneficiary tenant households were those who had stayed in place throughout the stabilization period, who, by 1987, were averaging savings of an estimated \$94 per month, or nearly 5% of their monthly incomes. Households that had stayed in place for the past 6-8 years were saving nearly 3% of income. The savings realized by households with between three and six years of tenure were non-trivial, at 1.3% of income, but seemed unlikely to represent the margin between keeping the unit and being forced to move to a less expensive one.

Although less clearcut than in 1984, the 1987 evidence also suggested that tenant households with less than three years of tenure not only received no benefit from rent stabilization, but

very possibly paid some premium above market rents in order to finance some or all of the subsidy to longer-tenured tenants. In 1984, this premium above market rent was measured to average \$15 per month, and this estimate showed as statistically significant according to standardized tests. The 1987 survey emerged with an estimated premium of \$11 per month, but, because of greater diversity in the results received from tenants in this subgroup, this estimate did not test as significantly different from zero premium. In light of these test results, all that can be concluded here is that no benefit seemed to flow to members of the 1-2.99 year tenure subgroup, and the figures that did emerge suggested an ongoing cross-subsidy from this group of tenants (plus those who moved in during the past year) to the longer-tenured subgroups.

Whatever the degree of cross-subsidy among tenant subgroups, however, there can be no question that the CPI-based ceiling-setting method introduced in 1985 did have the effect of holding average stabilized rents well below market levels. As is shown in Chart 3.9 below, this would not have been true if the flat 7% ceiling on increases had remained in effect.

CHART 3.9

INCREASES IN ALLOWABLE RENTS UNDER THE CPI-BASED FORMULA
AND THE FLAT 7% ALLOWANCE, RESPECTIVELY, AS COMPARED WITH
TWO MEASURES OF INCREASES IN MARKET RENTS, 1984 - 1987
(1984=100)

	<u>Increases Allowed by Alternative Ceilings</u>		<u>Actual Increases in Market Rents</u>	
	<u>CPI-Based Formula Adopted in 1985</u>	<u>Flat 7% Increase In Force 1979-84</u>	<u>Recent Mover Rents</u>	<u>Rent Com- ponent of Regional CPI</u>
1984	100	100	100	100
1985	105	107	N/A	108
1986	110	114	N/A	115
1987	115	123	124	122

SOURCES: Bureau of Labor Statistics, CPI Detail Report, January issues. The CPI estimates shown in are for all urban consumers in the Los Angeles-Long Beach-Anaheim area.

[NOTE: The All-Item CPI is designed to measure the cost of obtaining a fixed market basket of goods and services that constitute the necessities of life, including food, clothing, housing, transportation, and medical care. This is the basis for the ceiling-setting method adopted by the city Council in 1985. The residential rent component of the All-Item CPI measures the cost of renting a housing unit with fixed characteristics. This component is used lone here as one of two measures of the behavior of market (i.e., unregulated) rents. The other measure is the average rent charged to new tenants in stabilized units.]

The data in the Chart create a strong presumption that if the flat 7% ceiling on rent increases had remained in effect after mid-1985, the rent stabilization program would have exerted negligible suppressive impact on market rents, as measured by either of the methods used in the Chart. That is, average market rents would have increased by 22-24% by 1987 and the 7% ceiling would have allowed average stabilized rents charged to non-moving tenants to increase by an equivalent 23%.¹ Put another way, none or virtually none of the additional \$6 per month in increased benefits that stabilized households were realizing in 1987, as compared with 1984, would have accrued to them if the 7% ceiling had remained in effect.

In summary, looking across all of the data on overall benefits received by the stabilized tenant population taken as a whole, the 1987 data indicated that little had changed in the volume of rent stabilization benefits and costs since the CPI-based ceiling-setting method was introduced in 1985. But the continuation of the 1984 trends was wholly attributable to this change in ceiling-setting formula. Without it, there would have been a discontinuity in the form of cessation of any increase in stabilization benefits to tenants.

¹Since overall average stabilized rents include those charged to new tenants, the 7% ceiling would have permitted an even greater rise in this overall average.

Tenure, Demography and Benefit Distribution

Since the financial benefits of rent stabilization are so closely linked to a household's length of tenure, it is useful to review the demographic characteristics of the different tenure subgroups. The breakdowns revealed by both the 1984 and 1987 surveys are shown below in Chart 3.10.

CHART 3.10

AVERAGE DEMOGRAPHIC CHARACTERISTICS OF TENANT TENURE
SUBGROUPS, 1984 AND 1987

	<u>Length of Tenure in Unit</u>								
	<u>< 1 year</u>		<u>1 - 2 years</u>		<u>3 - 5 years</u>		<u>6+ years</u>		<u>9+ years</u>
	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>1987</u>
<u>Age of Household Head</u>									
<30	44%	45%	32%	30%	22%	23%	6%	4%	1%
30 - 61	51	51	63	61	62	70	60	65	62
>62	5	4	6	9	16	7	34	31	36
Average Age	35	33	36	38	42	39	52	51	54
<u>Average Household Income</u>									
<\$10,000	12%	7%	13%	11%	14%	10%	16%	12%	15%
\$10,000- 19,999	32	31	33	25	32	27	34	26	26
\$20,000- 29,999	20	23	24	28	21	25	19	28	25
\$30,000- 39,999	28	19	8	14	9	17	7	18	18
>\$40,000	8	20	22	23	23	22	23	16	16
Average Income	\$25,212		\$23,223		\$23,570		\$23,098		\$23,759
	\$27,206		\$27,743		\$26,730		\$25,210		
<u>Average Household Size</u>									
One	33%	23%	27%	24%	36%	26%	44%	44%	48%
Two	33	37	33	32	25	31	30	24	23
3-4	28	27	32	35	30	32	19	22	19
5 or more	6	12	7	9	10	11	8	9	10
Average Size	2.3	2.6	2.5	2.7	2.5	2.6	2.2	2.2	2.1

	Length of Tenure in Unit								
	<u>< 1 year</u>		<u>1 - 2 years</u>		<u>3 - 5 years</u>		<u>6+ years</u>		<u>9+ years</u>
	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>84</u>	<u>87</u>	<u>1987</u>
<u>HUD Income Classification*</u>									
Very Low	20%	29%	29%	25%	25%	29%	29%	27%	31%
Low	24	14	21	19	21	17	23	19	18
Moderate	19	30	22	25	22	21	19	25	23
Higher	37	27	29	31	32	32	29	30	28
<u>Race/Ethnicity of Household Head</u>									
White	54%	52%	53%	47%	48%	44%	58%	60%	62%
Black	19	9	19	11	24	18	19	15	16
Hispanic	18	31	17	30	22	27	17	20	19
Other	9	8	11	13	6	10	5	6	4
<u>Labor Market Planning Area Location</u>									
Area 1 (North-east)	3%	8%	6%	7%	6%	8%	6%	9%	8%
Area 2 (South Central)	16	10	18	13	19	16	18	12	14
Area 3 (Holly-wood-Wilshire)	48	26	44	21	43	30	50	35	51
Area 4 (Valley)	21	37	17	35	16	28	10	24	15
Area 5 (West-side)	8	12	12	14	12	8	11	12	11
Area 6 (Harbor)	3	7	3	10	3	10	5	8	2

* HUD classifies a four-member household as Very Low Income if it earns less than 50% of the area-wide median (\$17,950 in 1987), as Low Income if 50-80% of the median (\$17,951-26,550), and Moderate Income if 80-120% of the median (\$26,551-39,864).

We have seen that the greatest contrast among tenure subgroups in terms of the benefits/costs resulting from rent stabilization is between those who have stayed in the same unit since the onset of rent stabilization (the "longest stayers") and those who have moved into a stabilized unit during the past year (the "recent movers").¹ The Chart indicates that the dominant demographic characteristics of these two groups stayed reasonably constant in most respects between 1984 and 1987, but that some visible changes did occur.

At the high end of the benefit-receiving scale, in both 1984 and 1987 the longest staying households tended to be:

- * Middle-aged to elderly, virtually all over 30 and more than one-third over 62.
- * Low to moderate income, two-thirds under \$30,000 and one-seventh under \$10,000 per year.
- * Small in size, nearly three-quarters composed of no more than two persons, and nearly half single-person.
- * Headed by Whites, who accounted for about three-fifths of all longest staying households.
- * Concentrated in the Hollywood-Wilshire LMPA, which housed about half, while no other LMPA contained as many as one-fifth.²

¹The longest stayers, of course, had occupied their units for three more years by 1987, as compared with 1984. Therefore, the correct comparison is between those who had remained in place for six or more years in 1984 and those who had done so for nine or more years in 1987.

²The Hollywood-Wilshire LMPA is the City's largest in terms of stabilized housing, containing about 36% of the total stabilized stock.

Aside from the obvious fact that the heads of the longest staying households had aged in the interim, the most striking change in these prime beneficiaries of rent stabilization that occurred between 1984 and 1987 was that their average income grew very little. The increase was only \$662, far less than the \$2,700 increase in the average income of all rent stabilized households, and the average income recorded by this subgroup in 1987 was far and away the lowest for any tenure subgroup in that year. The longest stayers' increase during the period was limited to an average of less than 1% per year, a rate far slower than inflation even in these years of relative price stability. As a result, these households suffered an average loss in real income (i.e., discounted for inflation) of nearly 9%. With the median age of its heads of household reaching 54 in 1987, this subgroup clearly included many who moved into retirement during the period, usually decreasing their annual earnings, as well as many who were already on fixed incomes. Although income is not always an accurate indicator of the relative wealth of such households, there can be no question that their average purchasing power shrank noticeably over the three years¹.

¹Income (i.e., the assets received in the course of a year) is more likely to accurately reflect wealth (i.e., total net assets accumulated at a particular point in time) in the case of renter households than of homeowner households because the most frequent example of wealth that does not show up in the income stream is the homeowner's home.

At the other end of the spectrum, receiving no benefits from rent stabilization, and probably paying some margin of premium rent in order to finance the benefits received by the longest stayers, the recent mover households tended in both 1984 and 1987 to be :

- * Young to middle-aged, with nearly half less than 30 and virtually no household heads over 62.
- * Moderate income, with nearly two-thirds under \$30,000, but one-eighth or less under \$10,000.
- * Small to medium in size, with about two-thirds composed of two persons or less.
- * Nearly equally divided between White and Non-White household heads, though Whites accounted for just over half.
- * Less concentrated geographically, with no LMPA accounting for as many as half, and the plurality shifting rapidly from the Hollywood-Wilshire LMPA to the Valley.

The changes in the demographics of the recent movers were more numerous than in the case of the longest stayers. The head of the average recent mover household was a bit younger in 1987 than in 1984 (33 as against 35). Though the household was still much more likely to earn \$10-40,000 than to earn more or less, those outside that range were much more likely to be above it and much less likely to be below it in 1987. Fully one of every five recent mover household earned more than \$40,000 in 1987, as against one in 13 only three years before. Meanwhile, the proportion of recent movers which were single-member households fell sharply, while the proportion comprised of five or more members doubled.

But the most dramatic of the changes in the the composition of the recent mover population concerned their race/ethnicity and their geographic location. While the proportions of recent moving Whites and Other Minorities (primarily Asians) remained approximately constant, the share of households headed by Hispanics increased by more than two-thirds, and that of households headed by Blacks fell by more than half. As to location, the Valley LMPA replaced Hollywood-Wilshire as the place of highest concentration of recent movers, and there were also notable increases in the shares of the Westside, the Northeast and the Harbor LMPAs as well. In general it appeared that the major increase in the mobility of rent stabilized households which was traced in Chapter 2 often involved movement of younger households which were more likely to be Hispanic than in previous years and were more likely to move to or within the Valley. Though moving households included a larger share with relatively high incomes than had been true in 1984, their average income in 1987 was no longer far and away the highest among tenure subgroups, but were in the same range as those of households that had occupied their units for one to nearly six years.

The distribution of the benefits and costs of rent stabilization by tenure subgroup has already been provided earlier in this Chapter. Chart 3.11 on the following pages displays their distribution by demographic category in both 1984 and 1987.

CHART 3.11

ESTIMATED BENEFITS AND COSTS OF RENT STABILIZATION, BY DEMOGRAPHIC CHARACTERISTICS, 1984 AND 1987

	<u>Monthly \$ Savings from Market Rents</u>		<u>Savings as % of Average Annual Income</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
<u>Age of Household Head</u>				
<30 years	\$8	\$28	.4%	1.4%
30 - 61	14	20	.6	.8
>62 years	60	97	4.3	6.2
<u>Household Income</u>				
<\$10,000	\$65	\$42	13.9%	8.1%
\$10,000-19,999	38	47	3.4	4.1
\$20,000-29,999	16	26	.9	1.3
\$30,000-39,999	-18	23	-.7	.8
>\$40,000	-34	-4	-.9	-.1
<u>Household Size</u>				
One person	\$45	\$54	2.5%	2.5
Two persons	3	13	.1	.5
3-4 persons	-6	21	-.3	.9
5 or more	6	-11	.5	-.6
<u>HUD Income Classification</u>				
Very Low	\$55	\$43	8.3%	5.0
Low	24	27	1.8	1.7
Moderate	27	42	1.4	1.9
Higher	-33	- 2	-.9	-.1

	<u>Monthly \$ Savings from Market Rents</u>		<u>Savings as % of Average Annual Income</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
<u>Race/Ethnicity of Household Head</u>				
White	\$14	\$34	.7%	1.4%
Black	20	21	1.2	1.0
Hispanic	22	7	1.2	.4
Other	29	20	1.3	.9
<u>Building Size</u>				
1 - 5 Units	\$26	\$43	1.4%	1.8%
6 - 11 Units	31	35	1.5	1.6
12 or more Units	6	11	.3	.5
<u>Overall Average</u>				
All Household Avge.	\$18	\$24	.9%	1.1%

[NOTE: The data base from which benefits are estimated consists only of those responses which provided the full complement of information requested. This base is slightly smaller than the full universe of responses. Also, the characteristics of the model do not lend themselves to allocation of benefits by Labor Market Planning Area.]

The Chart shows that, while the general pattern of the 1984 demographic breakdown of the distribution of benefits and costs resulting from rent stabilization stayed pretty much in place in 1987, some significant changes also appeared to occur. First, though the benefits were still far more valuable to very poor households (i.e., those with incomes of less than \$10,000) than to any others in terms of share of income saved, both their dollar value to such households and the share of their income represented by the benefits declined over the period. Meanwhile, the financial significance of rent stabilization benefits to all other income classes below \$40,000 noticeably increased.

Second, despite their relative rarity among the longest-staying households, those households headed by persons under the age of 30 were sufficiently numerous in the longer tenure groups to begin to receive appreciable rent stabilization benefits for the first time in 1987. The same was true of households of three or four members, which in 1984 had registered as paying an average premium above market rent because of rent stabilization. Third, rent stabilization benefits grew very considerably in importance to households headed by Whites, but declined slightly (despite an increase in average dollar benefit) in Black-headed households, and fell off sharply as a share of the income of Hispanic-headed households and those headed by members of other minority groups. Finally, the residents of larger buildings (i.e., 12 or more

units) began in 1987 to receive average benefits roughly equivalent to the all-household average, after having averaged virtually none in 1984.

In spite of these changes, however, the basic pattern of benefit distribution among demographic groups reasserted itself once again in 1987. That is, the lion's share of the benefits were again directed to elderly households, to those consisting of one person, to those with income of less than \$30,000, and to those in smaller buildings. Of course, these groups tend to be heavily interrelated (i.e., most elderly households are small, of low to moderate income, and resident in smaller buildings). Unfortunately, however, it is not technically advisable in a survey sample of the 1987 size to attempt to analyze the benefits of rent stabilization within subgroups defined by multiple characteristics because the numbers of tenants in each subcategory in the sample quickly become very small -- usually too small to generate statistically significant indicators. Thus, our analysis of the demographics of the beneficiary population of rent stabilization must stop at this level of specificity.

Aggregate Annual Net Benefits to Tenants

Aggregate benefit estimates are important because they integrate the average size of the net benefit or cost experienced by different household types with the number of households of that type. The foregoing analysis suggests that rent stabiliza-

tion generated savings to the average stabilized tenant household amounting to a modest \$26 per month in 1987, compared to an even more modest \$18 per month in 1984. But what seems modest when expressed as average monthly savings per household is substantial from the perspective of the combined dollar benefits to all stabilized households in the City.

In aggregate, the data indicate that the 478,700 households occupying stabilized units in the City realized a total dollar savings below market rents of \$137.6 million in 1987. This was an increase of 29% over the \$106.9 million estimated to have been realized in 1984.

The distribution of the total dollar savings among household types is also instructive. Rather than focusing on the average benefit level received by each household of a given description, which has been the object of our attention up to this point, this distribution shows which types actually received more or less of the savings realized because there were more or fewer of them in the City. The household type that received the highest average benefit may not have received the largest volume of dollar savings because there are often so many more households which receive lower average but, because of their sheer number, higher aggregate benefits.

The distribution of the aggregate net savings realized by all stabilized households is displayed in Chart 3.12 on the following pages.

CHART 3.12

NET AGGREGATE ANNUAL MONEY BENEFITS OF RENT STABILIZATION,
BY TYPE OF BENEFICIARY HOUSEHOLD, 1984 AND 1987
(In millions of dollars)

	<u>Total Dollar Savings Below Market Rents</u>	
	<u>1984</u>	<u>1987</u>
<u>Age of Household Head</u>		
< 30 years	\$10.1	\$29.4
30 to 61	46.4	54.6
> 62 years	49.4	53.6
<u>Household Income</u>		
<\$10,000	\$64.8	\$21.6
\$10,000 - 19,999	86.9	65.8
\$20,000 - 29,999	23.7	35.1
\$30,000 - 39,999	-10.3	19.6
>\$40,000	-59.1	-4.5
<u>Household Size</u>		
One person	\$106.0	\$89.5
Two persons	5.9	22.4
Three to Four	-10.1	31.9
Five or More	4.0	-6.2
<u>HUD Income Classification*</u>		
Very Low	\$101.3	\$57.6
Low	37.3	23.0
Moderate	39.5	54.1
Higher	-72.5	2.9

Total Dollar Savings Below Market Rents
1984 1987

Race/Ethnicity of Household Head

White	\$46.5	\$100.6
Black	24.4	15.4
Hispanic	21.8	11.3
Other	13.1	10.3

Length of Tenant Tenure

<1 year	\$0.0	\$0.0
1 - 2 years	-21.5	-18.9
3 - 5 years	14.3	28.5
>6 years	113.2	128.0

Further Detail Collected in 1987 Only

6 - 8 Years	32.6
9+ Years	95.4

 * HUD classifications are explained in footnotes to earlier Charts.

This distribution of aggregate benefits serves to balance one's impression of the beneficiaries of rent stabilization. For example, although elderly households tend to receive the largest average benefits, the Chart demonstrates that more than 60% of the dollar savings in 1987 were realized by the much more numerous non-elderly households. Similarly, whereas single-person households continued to command much the largest average benefits in 1987, their share of total savings dropped considerably from the 1984 level, while those of all household size categories except the largest increased correspondingly. Finally, because of the much greater tendency of households headed by Whites to remain in their units for longer periods, their share of total savings increased substantially, while those of Black- and Hispanic-headed families declined despite the fact that the average benefit to Black households increased and that to Hispanic households held steady. A rounded view of the distribution of rent stabilization benefits must take into account these and other aspects of the sharing of aggregate savings.

Tenant Perceptions of the Financial Benefits of Rent Stabilization

The benefit estimates that are presented up to this point have been based on a statistical analysis of the probable financial effects of rent stabilization. However, both the 1984 and 1987 surveys also collected information regarding tenant perceptions of the effect that the RSO has had on their rents. These

tenant perceptions were obtained by asking respondents what they thought their units would rent for in the absence of rent stabilization. Chart 3.13 below summarizes the responses of the substantial majority (74%) of the tenants contacted who felt that they could make a quantitative estimate of this alternative unstabilized rent.

CHART 3.13

TENANT ESTIMATES OF MONTHLY SAVINGS REALIZED DUE TO RENT STABILIZATION, BY TENURE SUBGROUP, 1984 AND 1987

<u>Tenure Subgroup</u>	<u>Average Tenant Estimate of Savings</u>		<u>Statistically-Based Estimate</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
<1 year	\$94	\$53	\$0	\$0
1 - 2 years	116	66	-15	-11*
3 - 5 years	130	131	11	29
6 or more years	180	231	55	84
<u>Additional Detail Collected Only in 1987</u>				
6 - 8 years		283		64
9 or more years		206		94
<u>Overall Average</u>				
All-household average	135	136	18	24

* Not different from zero at 95% significance level.

[NOTE: The tenant estimates reported here include only those respondents who stated that their units were subject to stabilization, and excludes all tenants who said they did not know whether their rents were or were not stabilized.]

In a manner generally consistent with the results received in 1984, tenants in 1987 indicated the belief that the RSO was delivering about five times the savings estimated by statistical

analysis. However, their combined 1987 perceptions of average monthly benefit were about equal to their 1984 estimate, while average benefits are actually estimated to have increased by about 33%. Only the longest stayers estimated their benefits as higher today than they did in 1984, since they (correctly) perceived that these benefits have risen.

Of the minority of respondents who said that they were unable to provide a specific dollar estimate of the rent they would be paying but for stabilization, just over half (54%) said that unstabilized rents would be higher than those they pay under rent stabilization now. Twenty-nine percent reported rents would be about the same, and 17% thought that unstabilized rents would be lower than the rents they were paying if there were no RSO. Although the latter sentiment would seem inexplicable in the case of tenants of reasonably long standing, both the 1984 and 1987 surveys have indicated that it could be correct in the case of recent mover households.

All in all, the 1984 conclusion that tenants tend to believe that rent stabilization saves them much more money than it actually does was amply reconfirmed by the 1987 data.

Non-Monetizable Benefits of Rent Stabilization

One commonly discussed aspect of rent stabilization is the effect of the program on security of tenure. The RSO provides a variety of means to protect tenants against unjust eviction, and a variety of compensation devices for tenants who are evicted through no fault of their own. One way to assess the effect of the program on security of tenure is to estimate the proportion of households who could not afford to rent their current units in the absence of rent stabilization.

To do this, the gross rent-to-income ratios were calculated that would have resulted if rents had been at the predicted market rents used to estimate benefits, rather than at their stabilized levels. These rent-to-income ratios were then compared to the actual rent-to-income ratios derived from the 1987 survey. Chart 3.14 below presents the results of this comparison.

CHART 3.14

ESTIMATED DISTRIBUTION OF RENT-TO-INCOME RATIOS WITH AND WITHOUT
RENT STABILIZATION, 1984 AND 1987

Gross Rent-to- Income Ratio	1984		1987	
	Actual Distrbtn.	Distrbtn. Based on Market Rents	Actual Distrbtn.	Distrbtn. Based on Market Rents
< .20	36%	33%	34%	24%
.20 - .299	29	27	28	28
.30 - .399	17	17	16	19
.40+	19	24	23	29
	100%	100%	100%	100%

* Percentage may not sum to 100% due to rounding error.

If one accepts the Federal affordability criterion which holds that gross rents should not exceed 30% of household income, Chart 3.14 shows that in 1987 the RSO was keeping approximately 9% or 43,000 of the households residing in stabilized units within the affordability limit. On the other hand, the Chart also shows that even with rent stabilization, 39% of all households in stabilized units paid rents in 1987 that exceeded the 30% affordability criterion.

Variations by Community Area

Los Angeles is a large and diverse City consisting of many smaller communities, each with its own unique demographic characteristics. More than in most older, so-called radial cities, where suburbs ring a central core, Los Angeles has developed as a nodal accumulation of separate communities with distinct populations and living patterns. The situation of tenants in one of these communities may vary considerably from the Citywide average, and this difference cannot always be effectively captured using only the six Labor Market Planning Areas.

In 1987, for the first time, the review of RSO impact attempted to identify some of these variations by defining 13 distinct community areas, themselves aggregations of the 35 communities which form the planning areas for the City's General Plan. The boundaries of these areas are shown in Chart 1.3 in Chapter 1. Respondents to the tenant survey were asked to indicate what community they saw themselves as living in. These responses and their home addresses were used to place each respondent in one of the 13 geographically distinct community areas. As previously reported, the tenant sample was then amended so as to obtain at least 50 respondents from each of the 13 communities. In the end, more than 100 respondents were interviewed in seven communities, while at least 50 were interviewed in each of the remaining six areas.

The results from the community based subsamples must be used with care, since a sample size of 50 involves a potential error of $\pm 14\%$ and a sample of 100 an error of $\pm 10\%$, as against the $\pm 3\%$ potential error for statistics derived from the sample as a whole.¹ Still, the community data begin to give a picture of what the major variations are around the Citywide averages. Chart 3.15 on the following page shows variations in rents, income and gross rent-to-income ratios by community, all of which have previously been discussed from a Citywide perspective.

¹This is the standard error assuming a 95% confidence interval for a proportion.

CHART 3.15

COMMUNITY VARIATIONS IN AVERAGE RENTS,
INCOME, AND RENT-TO-INCOME RATIOS, 1987

<u>Area</u>	<u>Households in Stabilized Units</u>	<u>Gross Rent</u>	<u>Annual Hshld. Income</u>	<u>Ratio</u>
Citywide	478,700	\$525	\$25,931	29.2%
1. Sunland/Tujunga	3,071	497	22,079	30.5
2. Sun Valley/Sylmar	10,692	506	21,184	35.5
3. N.W. San Fernando Valley	23,028	602	29,726	31.2
4. No. Hollywood/Reseda	49,859	567	27,636	28.5
5. Toluca Lake/Woodland Hills	32,102	609	32,102	26.5
6. West Los Angeles	28,321	627	31,934	30.4
7. Hollywood	62,078	504	24,547	29.3
8. Central City/ N.E. L.A.	42,764	435	21,266	28.0
9. Wilshire District	83,912	507	26,511	29.4
10. Venice/Baldwin Hills	61,216	568	28,067	28.8
11. S. Central L.A.	61,788	444	19,776	31.2
12. Wilmington	10,100	402	18,615	27.7
13. San Pedro	9,768	575	31,603	27.1

Chart 3.15 makes it clear that tenants in rent stabilized units are not evenly distributed across the City. Fifty-six percent of the stabilized households (268,994) reside in just four communities -- the Wilshire district, Venice, South Central Los Angeles and Hollywood. Seventy-six percent of the tenant households in stabilized units live in these four areas plus North Hollywood and Northeast Los Angeles.

While the Citywide average gross rent was \$525 per month in the rent stabilized stock, tenant households in some of the largest areas of concentration of stabilized buildings were paying rents well below the Citywide figure. These include the \$507 per month average in the Wilshire District, the \$444 per month average in South Central Los Angeles, the \$504 per month average in Hollywood and the \$435 per month average in Northeast Los Angeles. The Citywide figure was clearly inflated by the higher rent levels in Venice (\$568), and North Hollywood (\$567), where there are very large concentrations of stabilized units, as well as in such other areas as West Los Angeles (\$627) where the concentration of stabilized buildings is smaller.

The community based data can also help identify possible mismatches between rents and income in particular areas of the City. In eight of the 13 communities the rent-to-income ratios hovered slightly below the 30% level, while three communities had rent-to-income ratios substantially above the Citywide average.

The greatest problem with rents that are classed as unaffordable by this definition was clearly in the three communities located in the northern portions of the San Fernando Valley and in South Central Los Angeles.

The problem of unaffordable rents is often attributed to insufficient income levels. The data in Chart 3.15 indicate, however, that income alone did not account for the variation in rent-to-income ratios. For example, the lowest household incomes were found in Wilmington, but, since the rent levels there were also below average, the rent-to-income ratio was one and one-half percentage points below the Citywide average. In South Central Los Angeles, income levels were also substantially below the Citywide average, but, because rent levels were relatively high, the rent-to-income ratio was 31.2, or more than two percentage points above the Citywide average. Thus, the problem of unaffordable rents could arise either from inadequate household income or excessive rent levels within any specific community.

Although the problem of apparently unaffordable rents was concentrated geographically within Los Angeles, a breakdown of these communities into four ethnic categories (White, Black, Hispanic and other) indicates that the problem was not restricted to a specific ethnic group. These data are shown in Chart 3.16 as percentages and counts of households by race and community. They indicate that there were roughly 30,000 White- and Black-headed households in these communities, and 33,000 Hispanic-

headed households. However, slightly more than one-half of the White-headed households resided in the Northwest San Fernando Valley, an area with household incomes that are substantially above the Citywide average. Although households in this community appeared to have a problem of excessive rent burdens, the affordability problem they faced was probably less serious than the one faced by households in the less affluent areas of the City.

CHART 3.16

COMMUNITY AREAS WITH HIGHEST RENT-TO-INCOME RATIOS,
BY RACE AND ETHNICITY

<u>Area</u>	<u>Rent to Income Ratio</u>	<u>Percent of Households:</u>			
		<u>White</u>	<u>Black</u>	<u>Hispanic</u>	<u>Other</u>
Sun Valley	35.5	53%	5%	40%	2%
South Central	31.2	8	46	41	6
N.W. S.F. Valley	31.2	72	8	16	5

By and large, therefore, it seems fair to conclude that, although there are major concentrations and levels of intensity of rent-related problems in different parts of the City, the basic issues with which rent stabilization policy is concerned appear in some form in virtually all subsets of the City's population.

Rent Levels in Unstabilized Housing Constructed in 1987

Because of the growing proportion of the current rental housing stock that is not covered by rent stabilization, special surveys were added in this study which were not performed in 1984, and which were designed to round out the portrait of the city's rental situation. These included a survey, carried out directly by the Rent Stabilization Division (RSD) of the Community Development Department (CDD), which identified and analyzed rents in brand new, unoccupied units coming onto the market during 1987 and 1988. Before proceeding to the results of this survey, it is important to have in mind both the scale of the recent boom in multi-family construction that was generally described in Chapter 2 and the unevenness of its geographic distribution within the City. Chart 3.17 on the following page paints this picture as it emerges from City records.

CHART 3.17

UNITS OF NEW MULTI-FAMILY HOUSING CONSTRUCTED IN
LOS ANGELES, BY LABOR MARKET PLANNING AREA,
1985-87

<u>Area</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>Total</u>	<u>% of Citywide</u>
LMPA 1 (Northeast)	1,025	964	510	2,499	4.1%
LMPA 2 (South Central)	410	482	340	1,232	2.0
LMPA 3 (Hollywood- Wilshire)	3,692	6,987	5,097	15,776	25.6
LMPA 4 (Valley)	10,048	9,637	4,927	24,612	40.0
LMPA 5 (Westside)	3,896	3,855	2,888	10,639	17.3
LMPA 6 (Harbor)	1,436	2,168	3,228	6,832	11.1
Citywide	20,507	24,093	16,990	61,590	100.0%*

* Totals may not add because of rounding.

The Chart shows that a total of 61,590 units of new multi-family housing, a total approximately one-seventh the size of the total stabilized stock, were constructed in just the three years ending in 1987.¹ (Of course, these units are unstabilized, as are all units constructed since 1978.) The Chart further shows that that eight of every 10 of these new units are in one of three LMPAs, and four of every 10 are in the San Fernando Valley. The Valley and the Hollywood-Wilshire Areas have together accounted for about two-thirds of all of these new units. Thus, the market in new multi-family housing, though much larger now than it was in the early 1980s, is relatively highly concentrated in a few major areas of the City.

In order to ascertain the rents being asked for units that first began renting in 1987, the RSD first identified all new multi-family residential buildings which were granted Certificates of Occupancy or rented for the first time during 1987. As previously noted, this survey included 7,425 apartments in 179 buildings that were first occupied by tenants in 1987. (The CDD refers to these as "newly constructed" units). Care was taken in the building identification process -- which included such sources as newspaper advertisements and personal visits as well as checking against the City's lists of buildings that had received construction permits and Certificates of Occupancy -- to

¹If 1984 were included, another 12,464 units would be added, bringing the total for the last four years to almost 73,400 new units.

be certain that the 179 buildings which survived the process included all which began renting units for the first time in 1987¹.

The average (contract) rents asked for these newly constructed buildings are shown below in Chart 3.18. In addition, for comparative purposes, previously presented comparable data on contract rents paid by tenants in stabilized and unstabilized units are also shown. (The Citywide figures for these two categories merely repeat the data which previously appeared in Chart 3.3.) Average rents are then shown for all three categories of rental units -- stabilized, unstabilized and newly constructed -- located in each of six geographic areas of the city.² These are the Labor Market Planning Areas (LMPAs) described and mapped in Chapter 1.

¹Particularly in the Northeast and South-Central parts of the City, the number of such buildings was sometimes quite small. In addition, one of the five new buildings in the South-Central area was not included in the analysis because it is a large complex adjacent to the University of Southern California whose rents appeared to be atypical of the other new rental units in that area. Because of its special characteristics, this building was excluded from the area-specific data base for the South-Central area, but it was included in the Citywide average.

²An asked for rent series, prepared by the RSD, that incorporates the rents charged in all three categories of rental of units is reported in the Technical Appendices to this Report.

CHART 3.18

AVERAGE MONTHLY CONTRACT RENTS ASKED FOR NEWLY CONSTRUCTED UNITS,
AND CHARGED FOR UNSTABILIZED AND STABILIZED UNITS RESPECTIVELY,
BY LABOR MARKET PLANNING AREA, IN 1987

<u>Area</u>	<u>Avge. Asked</u>	<u>Average Paid</u>	
	<u>Newly Constructed Units*</u>	<u>Un- Stabilized Units**</u>	<u>Rent Stabilized Units</u>
Citywide	\$903	\$639	\$492
LMPA 1 (Northeast)	747	448***	414
LMPA 2 (South Central)	695	332***	404
LMPA 3 (Hollywood Wilshire)	947	534	457
LMPA 4 (Valley)	782	668	536
LMPA 5 (West Side)	1,216	1,000	686
LMPA 6 (Harbor)	593****	620	470

* These are units occupied after January 1, 1987.

** These are units occupied after October 1, 1978 but before January 1, 1987.

*** These figures should be interpreted with care because of the small size of each subsample. There are fewer than 20 tenants in each these subsamples.

**** Since these newly constructed units were built in a less affluent part of the Harbor area, the rents charged are low relative to the rents for more typical units.

The Chart confirms the widely held perception that brand new apartment rents are expensive. At \$903 per month, the Citywide average was 41% higher than the \$639 average contract rent that was registered by households living in the unstabilized stock, all of which was occupied after the latter part of 1978. Unsurprisingly, therefore, it was 84% higher than the \$492 average contract rent paid by occupants of rent stabilized housing in 1987.

High as they were on average, however, average rent levels for newly constructed housing also seemed to vary less as among different areas of the City than did those in the rest of the unstabilized multi-family stock. Rents shown in Chart 3.19 for brand new units ranged from a low of \$593 in the Harbor area to a high of \$1,216 on the Westside, a difference of \$623 per month, or more than 100%. The range in the unstabilized but not "newly constructed" stock ran from \$332 in South Central to \$1,000 per month on the Westside. This was a difference of \$668, or 212%, or just over twice the range of geographic variance demonstrated by rents for brand new units. By these standards, the range described by average rents for stabilized units was narrow, coming to only \$282 (or 70%). The latter phenomenon, of course, reflects the fact that stabilized units are of a wide variety of ages and are situated in at least some numbers in all areas of the City, while units constructed during the past 10 years tend to be much more concentrated in location.

Average rents for newly constructed units and rents for other unstabilized units seemed to differ most narrowly in the Harbor, the Westside and the Valley. In the Harbor area the rents for newly constructed units actually appeared to be 4% lower than the average rents paid by tenants now occupying other unstabilized units in the area, though, as noted on the Chart, this may have been a misleading result of the location and type of the newly constructed housing in that particular location. In the Valley the average asking rent for newly constructed housing was only 17% higher than the average rent in unstabilized housing in the area. On the Westside, the difference was 22%. This suggests that in these areas builders of new buildings might well be able to attract tenants from the existing unstabilized stock into the newly constructed units. By contrast, the average rents being asked for newly constructed units in the Northeast, the South Central and Hollywood/Wilshire areas of the City were from 77% to 109% higher than the rents now reportedly being paid by tenants in unstabilized units. This may suggest a lower level of potential shift of tenants from existing to new unstabilized rental housing in these areas.

The difference in average rents charged for brand new housing and that charged for other unstabilized units that can be as much as nine years older is only one method of assessing the transferability of demand from the pre-1987 multi-family stock to the "newly constructed" stock. Another is to compare the average rents asked for the brand new units with the Federal

affordability standard of 30% of household income. Since we have seen that most unstabilized households have amply proven their willingness to spend well over 30% of their incomes in rent, this is more a measure of the test of prudence that is presented by the newly constructed units than it is a basis for forecasting the propensity of current unstabilized tenant households to shift to a newly constructed unit.¹

Chart 3.19 on the following page compares the average rents asked for a newly constructed unit with the average rent which is affordable to existing tenants in the City as a whole and within each LMPA according to the affordability standard (30% of household income) that is used by the Federal Department of Housing and Urban Development (HUD).

¹It should also be noted that the rents asked for the new units at the time of the survey may have been subject to change in light of the level of demand that emerged when these prices were quoted to prospective tenants. The rents paid for the older units, on the other hand, were actual charges. It may be, therefore, that the average asking rent for the newly constructed housing was a bit "softer" in terms of reflecting reality than the rent payment side of these comparisons. Also, it is quite likely that the market profile for takers of new housing will not resemble the overall average unstabilized household in income terms, but rather a subset of the unstabilized population with higher-than-average income. Comparisons with the overall average should be reviewed with this probability in mind.

CHART 3.19

AVERAGE MONTHLY CONTRACT RENTS ASKED FOR NEWLY CONSTRUCTED APARTMENTS COMPARED WITH AVERAGE HUD-DEFINED "AFFORDABLE" RENTS FOR UNSTABILIZED HOUSEHOLDS, BY LABOR MARKET PLANNING AREA, 1987

<u>Area</u>	<u>Avge. Rent Asked - Newly Constr- ucted Units</u>	<u>Average Affordable Rents in Unstabilized Households</u>	<u>Average Affordable Rents in Stabilized Households</u>
Citywide	\$903	\$769	\$648
LMPA 1 (Northeast)	747	616	556
LMPA 2 (South Central)	695	429*	556
LMPA 3 (Hollywood Wilshire)	947	635	613
LMPA 4 (Valley)	782	785	708
LMPA 5 (Westside)	1,216	1,140	908
LMPA 6 (Harbor)	593**	764	740

 * This figure arises from fewer than 10 observations because the incidence of unstabilized housing in this Area is quite low. This probably accounts for the anomaly in which average unstabilized rents in Area #3 registered as higher than average stabilized units.

** Because these newly constructed units were built in a less affluent part of the Harbor area, the rents charged are low relative to the rents for more typical units.

To the extent that both policy makers and consumers accept the validity of the 30% standard as a measure of housing affordability, the figures in Chart 3.19 may give reason for some concern. Particularly for households who now live in stabilized units, their implication is that most of the most recent fruits of the 1984-87 boom in multi-family housing construction is being marketed at prices that those now paying average rents in the rent stabilized population cannot begin to afford. Indeed, even those paying average unstabilized rents would need to stretch well beyond what the standard suggests as prudent in order to make room in their household budgets for the rent asked for a brand new apartment. Again, these findings probably have less to do with the likely volume of actual demand for newly constructed housing than with the issue of how accessible new housing should be to various income strata within the population. These numbers indicate that most of the new multi-family housing -- like most new single-family housing -- that is currently on the market is prudently accessible only to households in the higher reaches of the income distribution profile of the City. Whether or not this represents a policy problem is in the eye of the beholder. But there can be little question that it is a fact.

CHAPTER 4

THE SITUATION OF LOS ANGELES APARTMENT OWNERS

Introduction

In order to be effective, rent regulation must take account both of the burden of rents on tenants and the adequacy of rental income in buildings to sustain them as profitable enterprises for owners. If ownership as an investment over the long term does not yield a return that is comparable to that from investments of equivalent risk, then investment in rental housing will diminish and the quality of its stock and services will fall. This may not be a problem in the case of some types of economic activity, but housing is such a costly capital asset that its loss constitutes a serious social issue.

While few would dispute the need for an adequate rate of return to sustain the rental housing stock, definition and measurement of an appropriate level of return have been sources of intense disagreement. This Chapter explores the current situation of owners of the rental housing stock in Los Angeles. The analysis does not attempt to measure the actual rates of return on different types of buildings, as was done in the 1985 study through a survey of apartment building owners. Rather, it uses

information on the costs of the operation of rental housing in Los Angeles in order to show how revenues and costs have changed since the adoption of the CPI-based rent stabilization adjustment formula in 1985.

The Chapter is composed of three parts. First, we discuss the problem of estimating costs and rents and the sources of information that will be utilized. Second, the overall pattern of rents and costs of operation will be described. Third, the problem of rising insurance costs, which has been a source of much controversy in recent years, will be examined in more detail.

Analyzing the Financial Situation of Owners of Rental Housing

Two approaches to the analysis of the financial situation of rental housing owners are commonly employed. The first focuses on the investment decision of an owner to purchase or construct an apartment building that will be operated as a source of income as well as held as a capital asset with potential for appreciation. Such analysis requires detailed information about the purchase and sale of rental buildings as well as about their revenues and cost of operation. A second approach concentrates on the operating characteristics of buildings, their rent levels, costs of operation, financing, and occupancy over time. Although less definitive than an analysis that includes investment consideration, this method can provide a useful way of understanding the changing economics of operation of rental property. The

level of information necessary for this second approach may vary in detail. At a minimum, it should allow the analyst to determine whether the levels of rents and operating costs for rental housing have been moving in parallel over time, or whether they have diverged in a way that poses a threat to the financial viability of stabilized rental housing.

The 1985 study employed both methods to analyze the financial position of owners of rental housing, utilizing information on purchases and sales of rental property, and drawing on a detailed survey of owners with respect to the operation of their buildings. In addition, the study employed two secondary data sources: the information on rental housing operation collected by the Institute of Real Estate Management (IREM) as a service to the housing industry, and tabulations by the State of California Franchise Tax Board (FTB) based on tax returns from owners of rental housing in Los Angeles for 1983.

In the current study, it was determined that, rather than conducting a new -- and quite expensive -- survey of building owners, the key need was to assess the relative situation of apartment owners in the stabilized stock since the 1985 survey. Therefore, this analysis employs only the IREM and FTB as sources of additional data. However, the FTB data are substantially better than the data used in the 1985 study. Given these improvements in the collection of FTB data, which were made between the

two studies,¹ the results reported here may not be directly comparable to the FTB data previously collected. Thus, for historical comparison we continue to rely on the landlord survey data collected for the 1985 study. Because it is important to understand the origins of the information about rents and costs that are discussed in the following section, we will briefly describe the nature of each of the data sources.

The IREM data are collected and published annually by the Institute of Real Estate Management and cover many housing markets in the U.S., including the Los Angeles Standard Metropolitan Statistical Area (SMSA). Designed to assist management and marketing by operators of rental housing, the data provide a picture of rent levels and operating costs for various sizes and types of building within specific markets. Because of the operational uses made of it, there is some premium on the accuracy and validity of the information. Nevertheless, it is based on a relatively modest sample of buildings that tend to be larger and probably more professionally managed than the average building in the market as a whole. Also, IREM does not distinguish between buildings covered by rent stabilization and those which may not be so regulated. Finally, the SMSA upon which its sample is based is much larger than the City, so that the sample does not necessarily represent the rental housing stock in Los Angeles taken alone.

¹The changes are described in detail below.

The Franchise Tax Board data are, in many respects, complementary to that collected by IREM. They consist of tabulations drawn from tax returns filed in California by individual owners of rental property who used either the Schedule E form or a Worksheet in its place. In 1984, the Rent Stabilization Division (RSD) requested a match of all properties registered under the Rent Stabilization Ordinance, by building address, with income tax records for 1983 filed with the State. The FTB performed this match and then selected a random sample of about 4,000 properties on which to report. Strict confidentiality of information about individuals and properties was maintained in the course of the analysis. The only information released by FTB after it did the match of the registration list to the sample of returns on a building-by-building basis consisted of the total and average income and expense data, by size of building and by Labor Market Planning Area (LMPA). In 1987 the RSD requested that FTB update the 1983 tax return data for the sample for the tax years 1984, 1985 and 1986, and provide unit as well as property counts.

The major disadvantage of this data source from the perspective of this Report is that the data for 1987 are not yet available, since tax returns for the 1987 tax year were only recently filed in 1988. For similar reasons, the IREM data for 1987 are not yet available. Thus, there is available for analysis of owner experience information on only one year of experience, 1986, during which property owners operated under the CPI-based ceil-

ing-setting formula. This compares with two years of recorded experience, 1984 and 1985, with the prior flat 7% ceiling on increases.

The number of properties and units for which FTB-based data are available varies somewhat from year to year. For the 1985 study, FTB drew a sample of 4,000 addresses and then captured an initial sample of 3,765 properties, all of which had been registered for rent stabilization in 1984 and had also filed returns with FTB for 1983. However, in using the data, RSD noted that LMPA #4, the Valley, had been underrepresented in the sample.¹ In addition, in 1984 the FTB may not have correctly disaggregated the tax filings into individual property components. Thus, the 1983 FTB data are not reported here. Rather, as previously noted, the basis for comparison with 1983 conditions is the landlord survey which the 1985 study relied upon.

For this Report, a new sample of 3,800 buildings was selected by FTB using returns for the tax year 1984. In 1985, the FTB continued to track the same buildings but added new properties to replace some for which returns were not yet available. The 1985 sample thus contained 4,076 properties, some of which were not the same as the properties represented in 1984. Further adjustments were made in the 1986 sample, which contained 4,244

¹op.cit., HR&A, The Rent Stabilization System Exhibit 3-19, "Comparison of FTB and Landlord Survey Expense and Income Data".

rent stabilized properties. Each amendment of the composition of the FTB sample has been made with careful attention to maintaining its representative character.

In the 1985 Report the data could only be presented by property, not by unit. In this Report, the financial data are available by unit as well. Thus, the study focuses on unit-by-unit data for each year, representing 22,573 units in 1984, 24,332 in 1985 and 25,784 in 1986.

Even so, neither the FTB nor the IREM data nor the two together can provide a complete picture of the financial status of ownership of rental residential property in Los Angeles. While taken together they do permit us to see how rents and costs have fared over recent years, each source has some drawbacks. The IREM data are drawn from a limited sample comprising no more than 400 buildings in Los Angeles in any given year. These buildings tend to be larger on average and more professionally managed than those in the City at large. Thus, their financial characteristics probably do not reflect the situation of smaller property owners and buildings. Both rent stabilized and non-rent stabilized buildings may be included in the IREM sample, since no distinction is drawn between them. The sample is intended to reflect rental housing in the Los Angeles SMSA as a whole. Given the increase in the rate of new construction of rental housing in

recent years, IREM is probably a less relevant source as a measure of experience in the rent stabilized stock in 1988 than it was in the 1985 study.

The FTB data, on the other hand, are based on tax returns filed by only individual property owners of rent stabilized buildings. No partnership or corporate returns can be traced by the method utilized to link the building and the tax return. Thus, the data may be expected to reflect more smaller buildings and situations of owners of fewer properties than are representative of the buildings and owners of the stabilized stock as a whole. The relative scarcity of larger buildings is evident in Chart 4.1 on the following page, which provides a comparison by size of building and area in the sample used for the FTB analysis with those of the the rent stabilized housing stock as a whole. The FTB data reflect the rent stabilized housing stock quite well for the smallest category, namely 2-5 units. However, the next larger size group, 6 to 11 units, is somewhat over represented in the FTB sample, with a corresponding lack of observations in the category of buildings with twelve or more units.¹ In terms of geographic distribution, the FTB data under represents the South Central and Harbor areas, and over represents the Valley and the Westside.²

¹It will be recalled from the previous Chapter that residents of these larger buildings received significantly lower average benefits from rent stabilization than residents of smaller buildings. Thus, the FTB data probably tend to overrepresent building owners who are more financially affected by stabilization, as against those who are less affected.

²No comparable geographic information is available for the IREM Sample.

CHART 4.1

DISTRIBUTION OF RENTAL BUILDINGS BY SIZE AND AREA, FRANCHISE TAX BOARD SAMPLE AND ENTIRE RENT STABILIZED STOCK, 1984 AND 1987

Size of Building (Units)	<u>Percent of Total Buildings:</u>			
	<u>1984</u>		<u>1986</u>	
	<u>1984 FTB*</u>	<u>Actual Rent Stabilized*</u>	<u>1986 FTB*</u>	<u>Actual Rent Stabilized</u>
2 - 5	61.1%	60.0%	61.1%	60.9%
6 - 11	29.8	24.0	29.2	23.3
12+	9.1	17.0	9.8	15.8
<u>Labor Market Planning Area</u>				
1 (Northeast)	9.0%	10.0%	9.1%	8.8%
2 (South Central)	14.8	25.0	15.0	24.9
3 (Hollywood-Wilshire)	32.3	28.0	31.3	30.7
4 (Valley)	21.5	17.0	22.6	16.9
5 (Westside)	18.3	15.0	18.3	13.2
6 (Harbor)	3.9	6.0	3.7	5.4

* Total may not sum to 100% due to rounding.

As previously noted, the FTB data are available at present only for the first year -- 1986 -- after the change in the rent adjustment ceiling-setting formula from the flat 7% increase to an adjustment based on the Consumer Price Index for Los Angeles.¹ Therefore, any observed change in that single year cannot be taken as clear evidence of a trend. Its sole utility, as a technical matter, is to provide a snapshot of the situation of building owners in the immediate aftermath of the change.

In summary, available information about the financial status of rent stabilized buildings at the time of this study has some imperfections, but it is still likely to be broadly reflective of the Los Angeles housing market when considered as a whole. Both of the available data sources should be considered when inferences are made about the impact of rent stabilization on the financial viability of rental housing.

Income and Expenses in Rental Buildings

Since the best picture of the overall situation of all rental housing in the Los Angeles area over time is provided by the IREM data, we describe this information first. Chart 4.2 on the following page shows the pattern of rents and expenses for larger rental residential buildings from 1978 to 1986 according to IREM. In that period, median annual gross rent per square

¹The CPI used to make the rent adjustments is based on the entire Los Angeles-Long Beach-Anaheim SMSA.

foot rose steadily from \$3.78 to \$8.28, an increase of 119%. In the same period, net operating expenses rose from \$1.57 per square foot to \$3.23, an increase of 106%.

It is evident from the Chart, as reported in the 1985 study, that most of the slower increase in expenses as compared to rents was attributable to the drop in real estate taxes that followed the passage of Proposition 13 in 1978. Unadjusted for inflation, these taxes had just returned to their 1978 level by 1986, but their real value in 1986 (i.e., value adjusted for inflation) was still much below that of any earlier year on the Chart.

CHART 4.2

OPERATING INCOME AND COSTS IN MULTI-FAMILY RENTAL HOUSING,
LOS ANGELES REGION, 1978-86Median Gross Rents and Costs (per square foot):

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Gross per sq. ft.									
Total Income (GPTI)	\$3.78	\$4.31	\$4.76	\$5.50	\$5.81	\$6.41	\$6.94	\$7.71	\$8.28
Vacancy Factor	0.14	0.17	0.18	0.20	0.24	0.29	0.29	0.30	0.48
<u>Expenses per sq. ft.:</u>									
Administrative	0.30	0.26	0.28	0.35	0.40	0.41	0.46	0.51	0.52
Supplies	0.02	0.03	0.03	0.04	0.04	0.05	0.04	0.05	0.04
Electric (CA Only)*	0.07	0.08	0.09	0.11	0.10	0.09	0.11	0.11	0.13
Electric (CA + Apts)	0.19	0.23	0.25	0.29	0.31	0.32	0.35	0.29	0.41
Water (CA + Apts)	0.05	0.06	0.07	0.08	0.09	0.11	0.13	0.13	0.13
Gas (CA Only)*	0.04	0.07	0.09	0.08	0.12	0.17	0.17	0.15	0.14
Gas (CA + Apts)	0.07	0.09	0.11	0.10	0.16	0.21	0.22	0.17	0.19
Building Services	0.04	0.05	0.05	0.07	0.07	0.07	0.08	0.07	0.08
Other Operating	<u>0.03</u>	<u>0.04</u>	<u>0.03</u>	<u>0.04</u>	<u>0.04</u>	<u>0.02</u>	<u>0.03</u>	<u>0.03</u>	<u>0.03</u>
Subtotal: Operating	0.30	0.38	0.45	0.49	0.55	0.60	0.60	0.59	0.60
Security	0.02	0.03	0.03	0.04	0.05	0.06	0.05	0.04	0.06
Grounds/Maintenance	0.06	0.05	0.06	0.07	0.08	0.07	0.08	0.08	0.09
Maintenance/Repairs	0.22	0.26	0.32	0.32	0.32	0.35	0.39	0.42	0.44
Painting/Decorating	<u>0.12</u>	<u>0.16</u>	<u>0.16</u>	<u>0.16</u>	<u>0.17</u>	<u>0.19</u>	<u>0.22</u>	<u>0.22</u>	<u>0.29</u>
Subtotal: Maintnce.	0.43	0.49	0.55	0.58	0.62	0.65	0.71	0.74	0.85
Real Estate Taxes	0.31	0.21	0.22	0.24	0.25	0.26	0.26	0.26	0.31
Other-Tax/Fee/Permit	0.01	0.01	0.01	0.01	0.01	0.02	0.01	0.02	0.01
Insurance	<u>0.08</u>	<u>0.10</u>	<u>0.10</u>	<u>0.11</u>	<u>0.11</u>	<u>0.12</u>	<u>0.14</u>	<u>0.16</u>	<u>0.23</u>
Subtotal: Tax-Insur.	0.40	0.32	0.34	0.39	0.38	0.43	0.46	0.46	0.61
Recreation Amenities	0.02	0.03	0.04	0.04	0.05	0.04	0.04	0.04	0.05
Other Payroll	0.16	0.24	0.28	0.32	0.33	0.35	0.35	0.41	0.40
Net Operating Exp. (NOE)	1.57	1.69	1.87	2.14	2.21	2.43	2.61	2.87	3.23
Net Operating Income (NOI)	2.04	2.39	2.47	3.01	3.33	3.49	3.89	4.48	4.40
NOE/NOI	76.9	70.7	75.7	71.1	66.4	69.6	67.1	64.1	73.4

Source: IREM. Notes: IREM presents its data in terms of median square foot income and costs for each of four different building types. Consequently, the parts do not necessarily sum to 100%. The median values reported in this Chart were derived by weighting the values reported by IREM for eight building categories. The weights are based on the number of buildings in each category.

* Denotes expenses for common areas only.

According to the IREM data presented in the Chart, the median rental property in Los Angeles produced net operating income for its owner at the rate of \$4.40 per square foot in 1986, compared to \$2.04 per square foot in 1978, a 116% increase over the period. Some of this increase was due to inflation. However, when these nominal dollars of NOI are converted into 1986 dollars, as they are in Chart 4.3 below, an increase in net operating income remains. Owners in 1986 were earning, according to IREM, 90 cents a square foot, or about 26%, more in real terms than they were in 1978. Of course, this net operating income does not translate into owner profit on the building because it ignores both financing costs and any appreciation or depreciation in the sale value of the property. But these figures do tell the operating financial story.

CHART 4.3

REAL AND NOMINAL MEDIAN NET OPERATING INCOME, ALL LOS ANGELES RENTAL PROPERTIES, IREM, 1978 - 1986

	<u>Nominal NOI</u>	<u>Real NOI (1986 \$)</u>
1978	\$2.04	\$3.50
1979	2.39	3.70
1980	2.47	3.30
1981	3.01	3.67
1982	3.33	3.83
1983	3.49	3.94
1984	3.89	4.20
1985	4.48	4.63
1986	4.40	4.40

Note: IREM net operating income data indexed using Los Angeles-Long Beach-Anaheim All Urban Consumer CPI, published by the Bureau of Labor Statistics, U.S. Department of Labor.

The 1986 IREM figures for all properties are of particular interest because they reflect the first complete year of change under the Rent Stabilization Ordinance. The IREM data for that year suggest that for all rental properties net operating income fell in nominal dollars by eight cents a square foot (or 2%) and in real terms by twenty-three cents per square foot (or 5%), from its 1985 level. This decrease in NOI was attributable to a 60% increase in the vacancy factor, a 20% increase in real estate taxes, contributing to a 13% increase in net operating expenses, as against a rental income increase of only 7%.

Chart 4.4 on the following page shows the 1978-1986 shifts in the relative importance of the different components of operating cost, again according to IREM data. (The figures in the chart are median percentages of gross rents, and therefore, they do not add to 100%.)

Three points drawn from the Chart are especially notable. First, the vacancy factor for all rental buildings increased from 3.7% to 5.7%, presumably largely in response to the boom in new construction. (This increase was even larger between 1985 and 1986.) This, of course, reduced the increase in rental income that could have been earned from any uniform per-unit increase in rents charged. Second, the median ratio of net operating expenses to adjusted gross income, commonly called the expense ratio, fell from 41.3% to 38.9%. And, again, we see the effect of the fall in real estate taxes, which declined from 8.4% of gross income in 1978 to less than 3.7% in 1986. However, consumption of income by maintenance costs as a whole also decreased from 11.1 to 10.7% and direct operating costs fell by rather less. The share of income paid out for insurance, on the other hand, rose sharply at the end of the period, along with payroll expenses.

CHART 4.4

COMPOSITION OF BUILDING COSTS IN RELATION TO INCOME,
LOS ANGELES REGION , 1978-86

	<u>Median Percent of Gross Rent:</u>								
	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
GPTI	100%	100%	100%	100%	100%	100%	100%	100%	100%
Vacancy Factor	3.69%	3.65%	3.88%	3.79%	4.32%	4.56%	4.12%	3.07%	5.69%
Administrative	7.73	6.46	6.10	6.39	6.48	6.31	6.35	6.47	6.31
Supplies	0.53	0.65	0.66	0.66	0.68	0.67	0.63	0.63	0.64
Electric (CA Only)*	1.70	1.79	2.01	1.96	1.80	1.55	1.52	1.45	1.53
Electric (CA + Apts)	5.40	5.20	5.22	5.12	5.62	4.76	4.68	3.82	4.72
Water (CA + Apts)	1.32	1.43	1.47	1.58	1.75	1.76	1.98	1.66	1.57
Gas (CA Only)*	1.13	1.84	1.99	1.53	2.10	2.56	2.43	1.98	1.68
Gas (CA + Apts)	1.69	2.22	2.62	1.95	2.90	3.39	3.34	2.28	2.34
Building Services	1.00	1.32	1.28	1.20	1.26	1.13	1.11	0.91	0.92
Other Operating	0.62	0.80	0.71	0.86	0.63	0.29	0.52	0.48	0.44
Subtotal: Operating	8.42	9.42	10.11	9.29	9.92	9.19	9.05	8.31	8.23
Security	0.31	0.42	0.60	0.73	0.72	0.83	0.68	0.48	0.62
Grounds/Maintenance	1.34	1.21	1.26	1.27	1.27	0.98	1.10	1.05	1.00
Maintenance/Repairs	6.28	6.45	7.11	6.39	5.98	5.51	5.62	5.66	5.54
Painting/Decorating	3.07	3.50	3.05	3.07	3.11	2.95	3.23	2.86	3.60
Subtotal: Maintenance	11.11	10.87	12.06	11.19	10.76	10.22	10.23	10.02	10.65
Real Estate Taxes	8.43	4.95	4.81	4.66	4.37	4.05	3.90	3.47	3.67
Other-Tax/Fee/Permit	0.17	0.26	0.23	0.22	0.20	0.22	0.20	0.25	0.22
Insurance	2.18	2.41	2.23	2.09	1.77	1.86	2.16	2.03	2.80
Subtotal: Tax-Insur.	10.87	8.03	7.70	7.30	6.93	6.80	6.70	6.47	7.74
Recreation Amenities	0.63	0.61	0.81	0.64	0.78	0.67	0.94	0.53	0.65
Other Payroll	4.19	5.97	5.92	6.23	5.41	5.34	5.23	5.66	5.23
NOE	41.31	40.59	41.18	39.67	38.32	38.02	37.60	37.33	38.88
NOI	54.07	56.21	54.04	55.27	57.40	55.81	56.65	58.21	54.40

Source: IREM

Notes: IREM presents its data in terms of median square foot income and costs for each of four different building types. Consequently, the parts do not necessarily sum to 100%. The median values reported in this Chart were derived by weighting the values reported by IREM for eight building categories. The weights are based on the number of buildings in each category.

Despite these shifts in the expense detail, the broad picture is one of relative financial stability on operating account. Increases in operating costs certainly occurred during the past decade, but they were more than offset by owners' ability to increase rental revenues to match them. Other than the claims of insurance costs and the behavior of the vacancy factor, recent years show up as little different from general median conditions over the entire period. The IREM data suggest that the number likely to be most volatile in the next three years is the vacancy factor, which increased in 1986 to nearly 6%, or more than a full percentage point above the level it achieved in any previous year in the decade.

Moving from IREM to the FTB data allows us to examine how rent stabilized housing, specifically, fared in comparison to the entire housing stock in the years 1984 to 1986. Chart 4.5 below shows average income, operating expenses, and expense ratios derived from the FTB data for the full rent stabilized stock for these years. Similar data from the 1985 study are also presented for historical comparison. These data are from the landlord survey conducted in 1984,¹ rather than from the FTB.

¹The landlord survey conducted in the earlier study collected data for the then most recent calendar year, which was 1983. Thus, 1983 data were collected in late 1984 and published in 1985.

CHART 4.5

COMPARISON OF ANNUAL INCOME AND OPERATING COSTS IN STABILIZED RENTAL HOUSING, LOS ANGELES, 1983 - 1986

Average Value of Financial Indicator. By Unit:

<u>Financial Indicator</u>	<u>1985 Study</u>	<u>FTB</u>		
	<u>Landlord Survey</u>			
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Gross Income Per Unit	\$3,262	\$3,686	\$3,944	\$4,273
Operating Expenses Per Unit	1,418	1,446	1,512	1,709
Expense Ratio	43.5%	39.2%	38.3%	40.0%
Nominal Net Operating Income Per Unit	1,843	2,240	2,433	2,565
Real Net Operating Income Per Unit (1986\$)	2,071	2,409	2,508	2,565
Financing Costs	1,273	1,141	1,240	1,404
Nominal Pre-Tax Cash Flow	570	1,099	1,193	1,161
Real Pre-Tax Cash Flow	641	1,182	1,230	1,161

Source: Financial data for 1983 obtained from Exhibit 3-8 of 1985 study. Remaining data obtained from FTB.

Note: Financing costs in the 1985 study included both interest and principal. FTB data on financing report only interest.

The FTB data indicate that during the years 1983 to 1985, prior to the change in ceiling-setting formula, gross income per unit in stabilized buildings increased by about 21%, or at an annual rate of 10.5% per year. (Note that this average increase in income may consist of annual adjustments in rents charged for

non-vacated units together with changes due to vacancy decontrol and other permissible increases.) In 1986, after (but not necessarily because of) the introduction of the CPI-based ceiling formula, the increase in average income was smaller - about 8%. Meanwhile, operating expenses, which rose by about 7% from 1983 to 1985, an annual rate of about 3.5%, rose by 13% in the 1985-86 period. As a result, the operating expense ratio returned from less than 40%, where it had been in 1984 and 1985, to 40% in 1986. This was still substantially lower than the ratio that the landlord survey indicated was experienced in 1983.

Indeed, even after the 1986 increase the average level of the expense ratio also remained quite comparable to that exhibited by the IREM sample shown in the prior Charts. The median expense ratio for all buildings according to IREM was 38.0% in 1983 and rose to 38.95% in 1986 (see Chart 4.4). Since medians are normally lower than mean values for this type of distribution, the IREM and FTB figures are probably approximately the same, and the direction of change is certainly the same. All in all, there is little evidence that average overall operating expense ratios in rent stabilized housing differed substantially from those in the larger market.

Nevertheless, the result of the increase in expenses in 1986 and the simultaneous decrease in the rate of growth in income meant that cash flow fell in that year. Average net operating income per unit, which grew by 32.0% in nominal terms from 1983

to 1985, or by 16% per year, grew by only 5.4% between 1985 and 1986. Converted into real terms, the results were similar: NOI growing by 20.8% or 10.4% per year in real terms from 1983 to 1985, and then by 2.3% in the same terms between 1985 and 1986. But the previously reviewed IREM figures for the rental housing stock as a whole also showed a downturn in NOI in 1986, compared to its relatively steady upward progress from 1978 to 1985. Even with this downturn in NOI, however, owners were receiving almost 500 1986 dollars more per year in 1986 than they had been at the time the data for our last Report were collected.

It must be noted in addition that the average income reported by building owners was considerably below that implied by the reports of monthly rent payments by tenants. This phenomenon also emerged in the 1985 study. In that study, average contract rents reported by tenants in rent stabilized buildings were \$408 per month, whereas the data from the landlord survey indicated that gross income averaged \$272 per unit per month. Similarly, in this study the average 1986 contract rents derived from the FTB data imply an average rent of \$356 per month, whereas the sample of tenants in rent stabilized units who were surveyed reported that they paid an average of \$492 per month in 1987. It should be stressed that there are a number of valid reasons for some difference between the figures. The FTB data report averages based on the operation of entire buildings. Owners would not report rent for any units that were rent-free -- e.g., those occupied by owners or managers. Neither would rent be reported

for units that were vacant for part or all of the year, either because they were between tenants or were undergoing rehabilitation. Given that the FTB sample is weighted toward smaller buildings, many of them owner-occupied, a substantial part of the discrepancy may be attributed to these factors.

It must also be emphasized that aggregate figures such as those discussed above may conceal a great deal of variation across buildings of different sizes. This is certainly true for average rental income and expenses. Chart 4.6 on the following page displays average income and expenses by size of building, estimated from the FTB data for 1984-86, and from the landlord survey for 1983.

The Chart shows that rental income growth over the period varied substantially by building size. Larger buildings (12 units and over) essentially maintained their average rate of income growth for the pre-1986 period in 1986, at about 11% per year, whereas both intermediate sized and small buildings had slower rates of income growth after the CPI-based ceiling-setting formula went into effect. Income per unit in small buildings grew at 11% per year before the change, but at only 6% in 1986, while rents in medium buildings grew 11% per year from 1983-85 and 7% in 1986. It cannot be properly inferred from these facts that the slowdown was entirely caused by the new formula, but the two phenomena did coincide in time.

CHART 4.6

AVERAGE RENTS AND EXPENSES PER UNIT, BY BUILDING SIZE, RENT STABILIZED HOUSING, LOS ANGELES, 1983-1986

Average Value of Financial Indicator:

<u>Building Size</u>	<u>Landlord Survey</u>	<u>FTB</u>		
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>2 - 5 Units</u>				
Rent Per Unit	\$3,010	\$3,409	\$3,696	\$3,925
Expense Per Unit	1,210	1,421	1,543	1,649
Expense Ratio	40.2%	41.7%	41.8%	42.0%
Nominal NOI	1,799	1,988	2,153	2,276
Real NOI (1986 \$.)	2,021	2,138	2,220	2,276
<u>6 - 11 Units</u>				
Rent Per Unit	3,294	3,858	3,999	4,303
Expense Per Unit	1,339	1,228	1,487	1,643
Expense Ratio	40.6%	36.9%	37.2%	38.2%
Nominal NOI	1,956	2,630	2,512	2,660
Real NOI	2,198	2,828	2,590	2,660
<u>12 and Over Units</u>				
Rent Per Unit	3,365	3,774	4,157	4,598
Expense Per Unit	1,518	1,503	1,509	1,848
Expense Ratio	45.1%	39.8%	36.3%	40.2%
Nominal NOI	1,847	2,271	2,648	2,750
Real NOI	2,075	2,442	2,730	2,750

Source: Financial data for 1983 obtained from Exhibit 3-20 in the 1985 study. Financial data for 1984-86 obtained from FTB.

On the expense side, the data indicate that costs in larger and intermediate sized buildings tended to increase sharply in 1986 compared to the prior period. As a result, the average expense ratio was higher in 1986 than in 1985 in buildings of all sizes, but the jump was particularly noticeable in the largest class of buildings.

The net result was that, while buildings of all sizes increased their average net operating incomes again in 1986, as they had in 1983-85, the largest buildings did the least well in percentage growth terms. Nevertheless, in nominal dollars per unit owners of large buildings were still receiving \$903 more per unit in 1986 than in 1983, compared to \$704 more for the intermediate sized buildings and \$477 more for the smallest buildings. And, in real terms, properties of all sizes had realized increases in NOI between 1983 and 1986. There remained striking differences between averages for buildings of different building sizes, however. The smallest buildings realized the smallest real increase in NOI (\$255 per unit), while the largest realized the largest real increase (\$675), with the mid-sized buildings with six to ten units in an intermediate position (\$462). Between 1985 and 1986 on the other hand, size made little difference, as all building sizes realized very similar and rather small increases ranging from \$20 to \$70 per unit. (Note again, however, that the FTB data are least representative of large buildings.)

Important differences also existed among different areas within the City, as shown below in Chart 4.7, which reflects FTB data only. (When the two samples, FTB and the landlord survey, were subdivided into six LMPA categories, some aberrations may have occurred as a consequence of small sample sizes.)

It is noteworthy that the Chart reports expense ratios in the South Central area as averaging about 50% in 1986, as a result of relatively lower rents that were not matched by comparably lower costs. In contrast, the Westside area had both the highest average rents and the lowest average expense ratios both in 1984 and in 1986. No overall trend in expense ratios was detectable across all areas over the full period. It is notable, however, that costs rose more rapidly than rents in all areas during 1986, yielding distinct increases in the average expense ratios experienced in all areas.

NOI also rose in all areas over the period from 1984 to 1985, and it rose again in 1986, with the single exception of the experience in the Northeast, where nominal NOI actually fell somewhat from 1985 to 1986. Elsewhere, the biggest gain in NOI in 1986 was on the Westside, while the smallest gain occurred for owners in South Central Los Angeles.

CHART 4.7

AVERAGE RENTS AND EXPENSES PER UNIT, BY LABOR MARKET PLANNING
AREA, RENT STABILIZED HOUSING, LOS ANGELES, 1984 - 1986

LMPA Subarea	<u>Average Value of Financial Indicator:</u>		
	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>1 Northeast</u>			
Rent Per Unit	\$2,543	\$3,014	\$3,050
Expense Per Unit	1,121	1,217	1,287
Expense Ratio	42.4%	40.4%	42.4%
Nominal NOI	1,422	1,797	1,763
Real NOI	1,529	1,853	1,763
<u>2 South Central</u>			
Rent Per Unit	2,538	2,739	2,990
Expense Per Unit	1,302	1,313	1,493
Expense Ratio	51.3%	47.9%	49.9%
Nominal NOI	1,236	1,426	1,497
Real NOI	1,329	1,470	1,497
<u>3 Hollywood-Wilshire</u>			
Rent Per Unit	3,357	3,701	4,044
Expense Per Unit	1,356	1,509	1,698
Expense Ratio	40.4%	40.5%	42.0%
Nominal NOI	2,001	2,192	2,346
Real NOI	2,152	2,260	2,346
<u>4 Valley</u>			
Rent Per Unit	3,975	4,253	4,591
Expense Per Unit	1,614	1,597	1,779
Expense Ratio	40.6%	37.5%	38.7%
Nominal NOI	2,361	2,656	2,812
Real NOI	2,539	2,738	2,812
<u>5 Westside</u>			
Rent Per Unit	5,038	5,158	5,593
Expense Per Unit	1,599	1,671	1,934
Expense Ratio	31.7%	32.4%	34.6%
Nominal NOI	3,439	3,488	3,659
Real NOI	3,698	3,596	3,659
<u>6 Harbor</u>			
Rent Per Unit	3,390	3,622	4,036
Expense Per Unit	1,392	1,433	1,659
Expense Ratio	41.1%	39.6%	40.6%
Nominal NOI	1,998	2,229	2,377
Real NOI	2,148	2,298	2,377

Source: FTB

Changes in real NOI per unit painted a somewhat more complicated picture because properties in the Northeast and Westside areas experienced decreases in real NOI at some time between 1984 and 1986, while increases in real NOI of roughly \$200 per unit were realized in all other areas of the City. As shown in Chart 4.7, properties in the Northeast experienced a decrease in real NOI of \$90 between 1985 and 1986. But, between 1984 and 1986, properties in the Northeast realized a real increase of \$234 per unit, an increase which was comparable to all other areas of the City except the Westside. The experience of properties in the Westside is somewhat different. Average NOI decreased there between 1984 and 1986 and between 1984 and 1985, but it increased between 1985 and 1986. The real increase in NOI from 1985 to 1986, however, was not large enough to offset the decrease that occurred from 1984 to 1985.

These data suggest that operating expenses increased relative to gross rents in 1986, following the change in the rent adjustment formula. But for the most part, this shift did not stop the continuation of real net positive average cash flow increases in any building size category or in any area of the City. And the same cost pressure -- which was also indicated by the downturn in NOI in the IREM data -- was apparently occurring in all rental buildings, not just in the stabilized stock. In sum, although we have no direct information on the precise operating profitability of rent stabilized housing, the available

data on income, expenses and net operating income do not suggest any major shifts to average unprofitability during the period after the formula change as compared to the period before it.

The FTB data also allow calculation of the average ratio of estimated "before tax cash flow"¹ to gross rental income for the categories of housing discussed above. Financing costs have already been shown (in Chart 4.5), along with before tax cash flow. The ratio is shown in Chart 4.8 on the following page. This ratio measures the extent to which buildings in the sample are generating cash after expenses and also after debt service has been paid.² Although not a direct measure of profitability, since neither the average level of equity nor the total value of the buildings nor the rate of appreciation is known, the ratio does provide an indication of financial pressure on buildings, and it allows comparison of the situation of these owners with general expectations in the field of real estate.

¹The FTB estimate of before tax cash flow differs from the customary definition of before tax cash flow because principal payments are excluded.

²Depreciation is excluded from these calculations.

CHART 4.8

AVERAGE RATIO OF BEFORE TAX CASH FLOW TO GROSS RENTS,
RENT STABILIZED HOUSING, LOS ANGELES, 1983-86

Average Ratio of Before Tax Cash Flow to Gross Rents (Percent)				
<u>Category</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Citywide	16.9%	29.8%	30.2%	27.2%
<u>Building Size</u>				
2 - 5 Units	26%	23.9%	22.5%	20.4%
6 - 11 Units	18	34.7	34.6	32.8
12 + Units	15	29.4	32.5	26.9
<u>Labor Market Planning Area</u>				
1 Northeast	9%	24.6%	28.9%	26.4%
2 South Central	19	12.3	18.4	13.7
3 Hollywood- Wilshire	22	30.7	30.4	27.8
4 Valley	5	24.8	27.8	24.7
5 West Side	21	41.2	38.5	35.6
6 Harbor	25	21.7	20.6	17.3

Sources: Financial data for 1983 obtained from HR&A, The Rent Stabilization System, Exhibit 3-11 Financial data for 1984-86 obtained from FTB.

The before tax cash flow data appear to be very different for 1983, taken from the landlord survey data, and for the FTB based years, 1984-86. This may be because the FTB data include interest deductions only, while the survey data included repayment of principal as well as interest. Also, in response to the 1983 survey, information on financing costs was sometimes missing, so that pre-tax cash flow could not be calculated for the full sample of properties. Thus, although the 1983 data are presented again here for information, it is probably prudent to look primarily at the FTB figures for the 1984-86 period.

It can be seen from Chart 4.8 that before tax cash flow averaged about 30% of rents during the period 1984-86 and fell between 1985 and 1986. This general average level seems consistent with a healthy market situation for owners. With expenses running at about 40% of income, and debt service at 30%, about 30% of gross income remained, on average, as return to the owner before tax effects were taken into account. Since this cash flow was in effect, return on equity, owners with a level of equity equal to debt must have been receiving a rate of return comparable to the mortgage interest rate,¹ when the additional component of debt service attributable to principal has been taken into account. If their equity were proportionately lower, then the

¹Since the 1984 Study indicated that the average holding period for buildings was 14 years and because above-market mortgage rate loans are likely to have been refinanced, the average cost of mortgage money would be below the current market mortgage interest rate. Hence, we cannot assume that the investor is earning the current rate, but rather should assume a weighted average cost of debt for these properties.

return to equity would be higher. If their proportion of equity were higher, then the rate of return would be correspondingly lower. For example, for an average building, if debt is equal to two thirds of value, then the before tax rate of return to equity in the current year will be twice the mortgage interest rate adjusted for the principal element of the debt service. For the opposite state of affairs, where debt is only one third of value, the rate of return will be only one-half the mortgage rate and the owner will not be doing well on current account.

However, all of this ignores any effect of appreciation or depreciation in building value on the investor's return. While we do not have localized evidence on appreciation in residential income property markets, the Frank Russell Co., which ranks institutionally held commercial real estate and periodically measures changes in income and value for regional pools of property, reports that during the last 36 months there has been a 1.6% decline in asset values nationally.¹ This apparent trend should be taken into account in assessing the current average financial circumstances of building owners.

There are no data on debt-to-equity ratios for the buildings in the FTB analysis. However, the survey of owners in 1984 found that, for a limited sample of owners who had held their buildings for an average of fourteen years, the initial loan-to-value ratio

¹NCREIF Real Estate Performance Report, Fourth Quarter 1987 Results, published by the Frank Russell Co. and the National Council of Real Estate Investors Fiduciary, 1988.

had averaged about 73%, and the current ratio of debt-to-value was about 30%. Most of this shift was due to appreciation of the value of the property that had not been matched by equivalent increases in income. If debt continued to represent such a small average proportion of value for the FTB buildings in the 1984-86 sample, while consuming approximately half of average net operating income, then the rate of return to equity on an annual basis would be about half the mortgage interest rate, an unattractive proposition on its face. Economically rational owners would then have to be holding these buildings for appreciation and tax benefits. But, it is hard to see where this appreciation would come from in the absence of sizable rent increases. More likely, the FTB data represent a more accurate cross section of buildings in the City than did the survey. If so, the length of ownership would be shorter and the corresponding ratio of debt to value higher.

It should be noted however, that before tax cash flow fell everywhere between 1985 and 1986. The Citywide decrease was reflected in every building size and LMPA category. However, as with prior differences between 1985 and 1986, it is important to remember that this small change, up or down, may be partly a reflection of the sampling variability from year to year.

As with other ratios, the level of before tax cash flow to gross income varied greatly across the building stock and areas of the City. Chart 4.8 suggests that in the 1984-86 period this

ratio was lowest for the smallest buildings (2-5 units) and in the lower income areas, especially the South Central LMPA. In view of the previous discussion, it is difficult to see how owners in the latter area could have been doing well unless they were highly leveraged at historically low interest rates. Common experience of small owners in poor areas would suggest just the opposite, that they may have lower levels of debt at higher rates or are financed outside the conventional market. If this is the case, then the rate of return on these buildings and areas was on average substantially lower than elsewhere in the City. Conversely, for the Westside area, the ratio of before tax cash flow to gross income was over 35%. Although falling during the period of measurement, this general level would appear to indicate a high rate of return in moderately leveraged buildings. Only with significant price declines would these buildings not be generating reasonable returns.

Increases in the Cost of General Liability and Property Insurance

Owners of rent stabilized property in Los Angeles have indicated to the RSD that they are particularly concerned about large increases in the cost of general liability and property insurance that have occurred since 1984. The property owners report that the cost of insurance has increased much more rapidly than the CPI-based ceiling on rent increases for stabilized units, and that, as a consequence, operating expenses have increased relative to rental revenues. Using several secondary

data sources, this section of the Report attempts to document the actual changes in insurance costs for rental properties in Los Angeles between 1978 and 1986, and the probable effects of these changes on operating expenses.

The analysis that follows is based on three primary data sources: 1) Insurance Services Organization (ISO) manual rates for general liability insurance in Los Angeles from 1980 to 1987; 2) California State Franchise Tax Board (FTB) tax returns for individuals reporting income from rental housing in Los Angeles from 1983 to 1986; and 3) Institute for Real Estate Management (IREM) reports of income and expenses for rental properties in Los Angeles from 1979 to 1986. The ISO data document changes in the general liability rates that ISO has advised its 1,400 member insurance carriers to charge for rental property liability insurance,¹ while the IREM and FTB data document the actual costs of all insurance coverage to owners of rental properties.

Given the much publicized liability insurance crisis of the past few years, it is not surprising that these data strongly support the property owners' claims that the cost of insurance has increased more rapidly than the CPI-based ceiling on rent

¹ISO develops advisory rates on many different lines of insurance, based on loss experience that it receives from its members. These "manual rates" may or may not be those actually charged by any individual carrier to any particular insured. The actual rate is determined by each carrier in the light of market conditions and the particular risk situation and history of the insured.

increases. However, it is less obvious that these increases in insurance costs have been translated into substantial increases in operating expenses or into decreased net operating income.

In 1986 the share of insurance expense as a percentage of operating expenses ranged from 7 to 10%, according to the IREM and FTB data, respectively. Given this relatively small cost share, a large percentage increase in insurance expenses can leave the proportion of operating cost devoted to insurance still small, relative to total operating expenses. Operating expenses consist of many cost components that do not necessarily move in the same direction. On balance, it appears that increases in one expense -- insurance -- have been largely or fully offset by decreases in other components. Finally, vacancy decontrol has allowed landlords to adjust rents to market levels which incorporate increases in the cost of operating rental property and result in a cost pass-through to tenants. Since we have already seen that roughly 55% of the stabilized rental units in Los Angeles were vacated at some time between 1984 and 1987, many landlords have had the opportunity to adjust rents to account for changes in operating costs. Thus, it is not surprising that rents for units occupied by new movers have increased by 24% between 1984 and 1987, a figure which is well in excess of the 12.6% change in the all item CPI during the same period. This average increase in rents marked to market has apparently occurred in part in order to defray enlarged insurance costs.

This section begins with a discussion of changes in ISO manual liability rates since 1980. This is followed by a discussion of changes in insurance costs as measured by the IREM and FTB data. Finally, the effects of changes in the cost of insurance coverage on operating costs is considered.

Changes in ISO Manual Rates for Liability Insurance

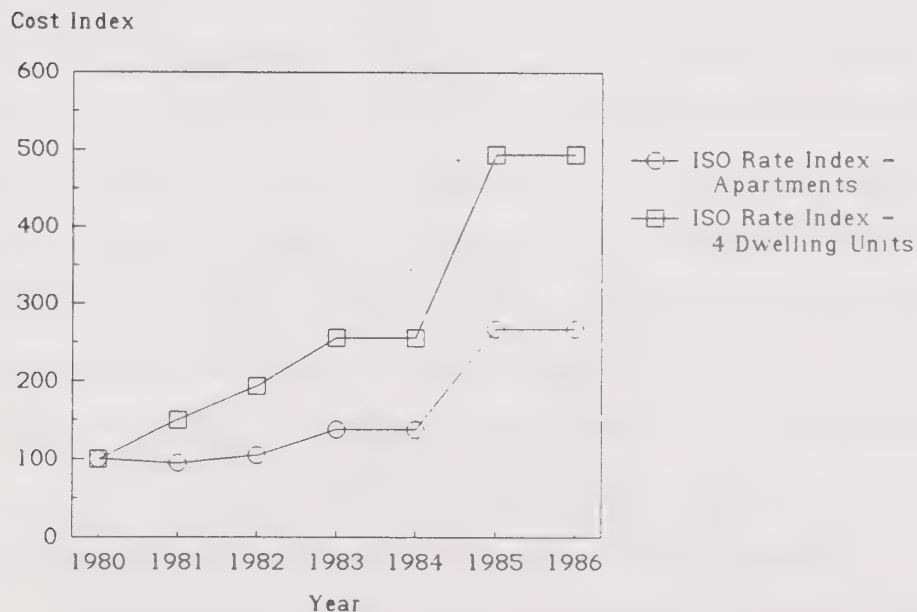
The Insurance Services Organization (ISO) collects loss data, and estimates and publishes manual rates for many lines of insurance, including general liability insurance for rental housing. The ISO manual rates are based on actual loss experience for member organizations and as such represent a reasonable basis for tracking trends in the cost of liability insurance before adjustments are made by carriers for the business and strategic considerations that enter into pricing and marketing insurance products. The rates published by the ISO are not binding, but many insurance companies, particularly smaller ones, use the ISO rates to assist them in setting their rates.

Of the four classes of rental housing used for classification purposes by liability insurance underwriters, we identified two illustrative classes that bracket the maximum and minimum cost increases since 1980: 1) rental housing with four dwelling units; and 2) apartments, tenements and boarding or rooming

houses.¹ We calculated a cost index based on the manual rates for each of these classes, running from 1980 to 1987, for the Los Angeles County territory, which includes the City of Los Angeles. The cost indices are shown in Chart 4.9.² Their behavior is quite consistent with the concerns expressed by landlords about rapid and large increases in the cost of liability insurance.

CHART 4.9

INDICATORS OF INSURANCE COSTS FOR
RENTAL PROPERTIES IN LOS ANGELES: ISO MANUAL DATA



¹The other two classes of rental properties are duplexes and triplexes.

²See Technical Appendices for tabular data used to construct the Chart.

As the Chart shows, between 1980 and 1984 increases in the ISO manual rates ranged from 38 to 156%, increases which are far in excess of the 31% rent increases allowed for stabilized properties during the same period. And, consistent with landlord complaints, these increases paled before the increases in manual rates between 1984 and 1985, which ran 94% for apartment buildings and 93% for fourplexes.

Since ISO manual rates are not binding on carriers, however, there is no assurance that they reflected actual pricing behavior, particularly during the turbulent financial conditions that prevailed during the early and mid 1980's. Indeed, there is a great deal of evidence that manual rates were routinely ignored by major carriers during the fierce price war they waged in commercial liability lines -- particularly general liability --during 1981-85. Since that conflict eased, it is reasonable to presume that the ISO manual rates began to provide a better indication of what was actually happening in the insurance market. However, these rates are still quite inexact reflections of those developments. Consequently, in the next section the ISO rates are compared with actual costs of insurance as reported by landlords to the IREM operating cost survey and in tax returns filed with the FTB.

Changes in Reported Insurance Expense

As shown below in Chart 4.10, the ISO manual rate indexes are strikingly similar to a cost index constructed from insurance expenses per square foot measured by IREM.¹ Since the IREM data exclude buildings with fewer than 12 units, it is interesting to note that the IREM cost index parallels the ISO rate series for apartments almost exactly until 1984, when a major rate increase occurred in ISO rates.² Following the sharp increases in ISO manual rates in 1984, the costs actually incurred by insureds fell somewhat behind. If this lagged relationship continues to hold, then apartment owners may expect to receive additional rate increases in the near future.

¹See Technical Appendices for tabular data used to construct the Chart.

²In general, the accuracy of manual rates as predictors of actual rates charged should be greater for small buildings (or other commercial enterprises) than for large ones. Most of the deviation from manual rates has traditionally been for large entities which represent important individual elements of market share for the competing carriers.

CHART 4.10

INDICATORS OF INSURANCE COSTS FOR
RENTAL PROPERTIES IN LOS ANGELES: 1980 - 1986

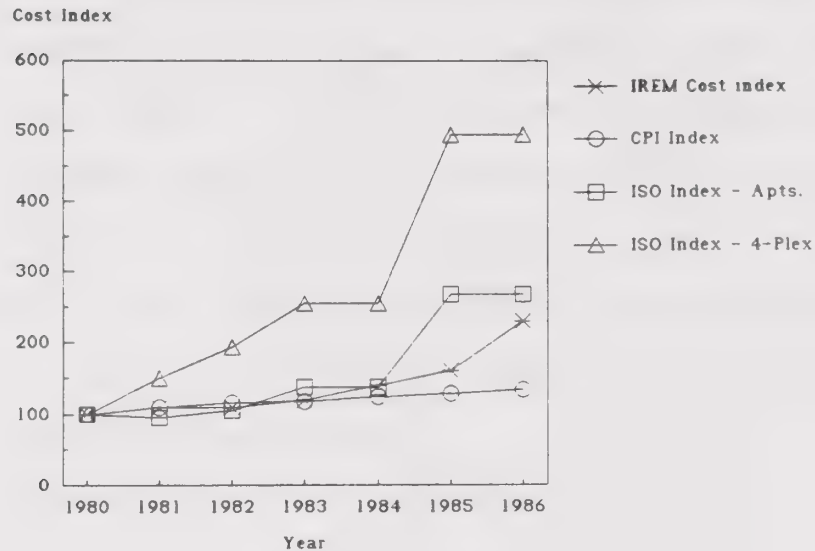
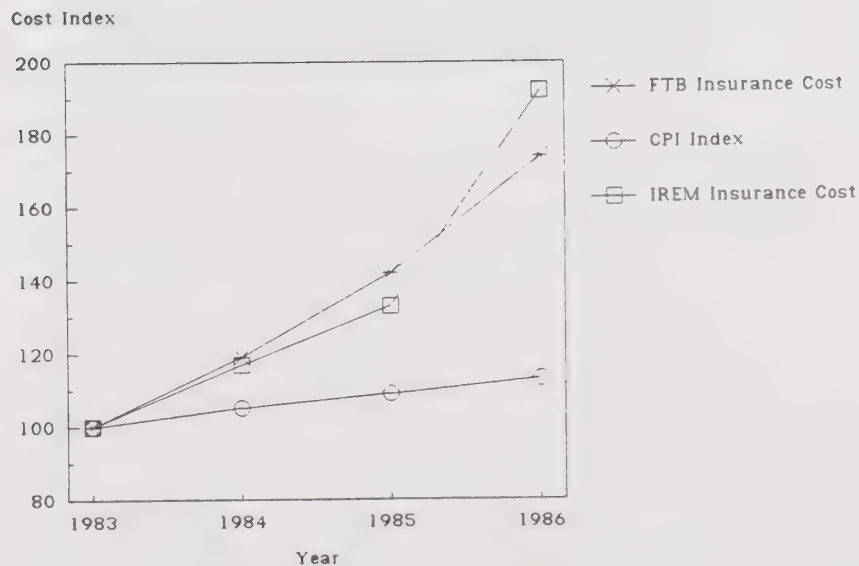


Chart 4.10 also shows an index constructed from the CPI for all urban dwellers in Los Angeles that forms the basis for allowable rent increases for stabilized units. Comparison of this index with the IREM insurance cost index suggests that insurance costs and allowable rent increases began deviating between 1984 and 1985 when the ISO manual rates increased dramatically. In fairness it must be pointed out that this manual rate increase followed upon the three worst operating years in the history of the property/casualty insurance industry. It is entirely possible, therefore, that prior to the increase, manual rates were insufficient to cover probable losses.

The FTB index shown in Chart 4.11 closely matches the IREM index between 1983 and 1986.¹ Both cost indexes consistently show increases in insurance costs that exceeded the CPI index, which is also shown in Chart 4.11. In percent terms, the CPI increased by 13% between 1983 and 1986, while insurance costs increased by between 75% and 92%, depending on the cost index used. Thus, there is little doubt that the property owners' concerns regarding insurance cost increases are well founded. In the next section, the effects of the insurance cost increases on operating expenses are considered.

CHART 4.11
INDICATORS OF INSURANCE COSTS FOR RENTAL
PROPERTIES IN LOS ANGELES: 1983 - 1986



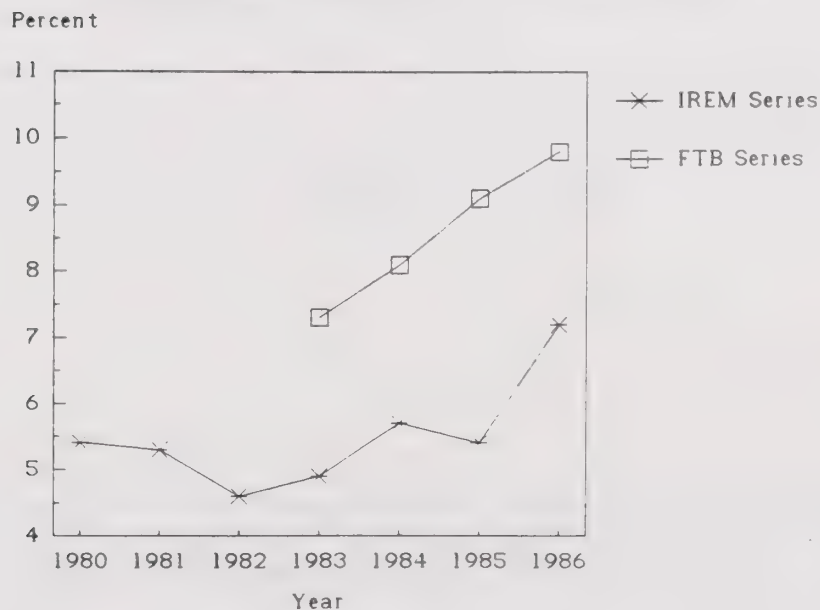
¹See Technical Appendices for tabular data used to construct the Chart.

Changes in Net Operating Expenses Relative to Insurance Expense

Insurance costs measured as a percentage of operating expenses by both the IREM and FTB data have been increasing, as shown below in Chart 4.12.¹ The cost share of insurance is roughly 2.5 to 3 percentage points higher in the FTB data than in the IREM series, which may be due to the economies of scale available to property owners with larger buildings reflected in the IREM data. The Chart shows that the cost share of insurance in the IREM data has fluctuated somewhat, between a low of 4.6% in 1982 and a high of 7.2% in 1986. The cost share for insurance in the FTB data has increased almost uniformly from 7.3% in 1983 to 9.8% in 1986.

CHART 4.12

INSURANCE EXPENSE AS A PERCENTAGE OF OPERATING EXPENSES: 1980 - 1986



¹See Technical Appendices for tabular data used to construct the Chart.

Both sets of operating expense data support the landlords' claims that insurance expenses have increased more rapidly than the CPI-based ceiling on rent increases, and that the cost share of insurance as a percentage of operating costs has increased as well. Thus, all other things being equal one could expect that this rising insurance share of operating costs would lead to increased total operating expenses and reduced net operating income.

However, when net operating expenses and insurance expenses are calculated as a percentage of rents' using the IREM and FTB data, neither data set indicates a relationship between increased insurance costs and increased operating costs as a percentage of rents.¹ This is shown in Charts 4.13 and 4.14 on the next page.² Using the IREM data, the insurance cost share increased consistently from 1982 to 1986, excluding a slight drop in 1985, while the operating cost share declined until 1986. The FTB data paint a similar picture between 1983 and 1985: an increasing insurance cost share and a decreasing net operating expense share, until operating costs turned up slightly in 1986.

¹The rent bases for the two calculations differ somewhat. The rent base for the IREM data is gross possible rents, while the rent base for the FTB data is actual rents received.

²See Technical Appendices for tabular data used to construct the Chart.

CHART 4.13

NET OPERATING EXPENSES AND INSURANCE EXPENSES AS
A PERCENTAGE OF GROSS POSSIBLE RENTS: IREM DATA

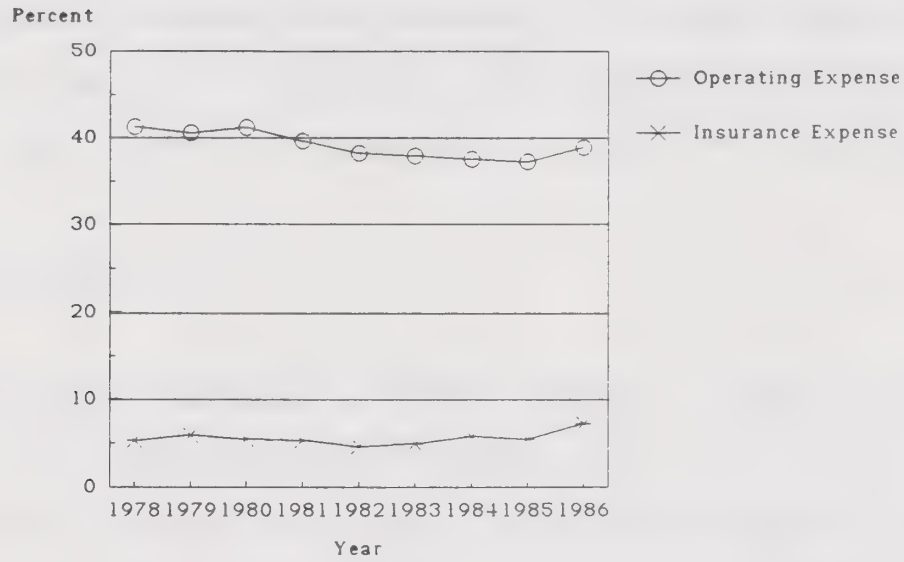
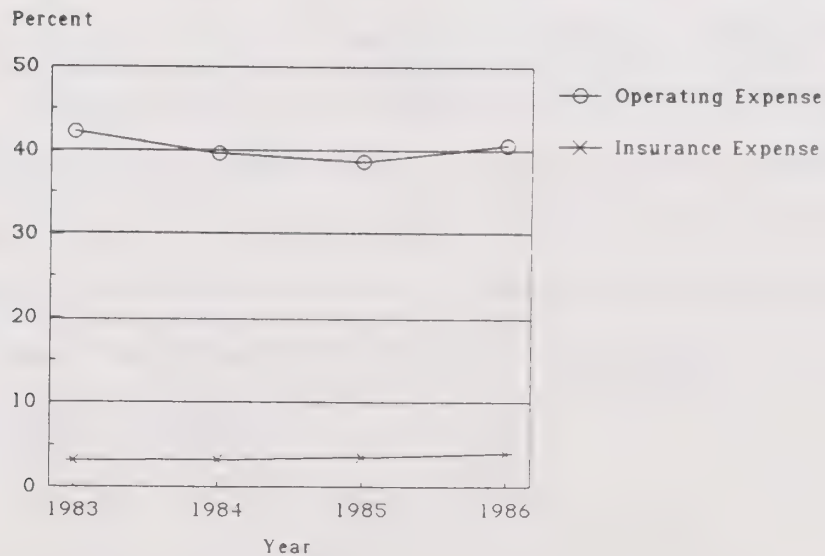


CHART 4.14

NET OPERATING EXPENSES AND INSURANCE EXPENSES AS
A PERCENTAGE OF ACTUAL RENTS: FTB DATA



In sum, it appears that the cost share of insurance has been and remains relatively small. Consequently, large increases in insurance costs have not increased operating costs by the same percentage. Second, it appears that offsetting fluctuations in the prices of various other components of operating costs have kept the rise in insurance costs from being expressed either in higher total operating expenses or in lower net operating income.

Overall Conclusions

Reviewing the full -- though limited -- body of data bearing on the behavior of landlord finances since the CPI-based ceiling-setting formula was adopted, the evidence suggests that the new formula did not materially harm the financial situations of owners. Net operating income remained positive in both nominal and real terms, and the competitiveness of investment in multifamily housing did not seem to decline at least in cash flow (as approved to tax) terms. Little is known about the behavior of the capital asset value of rental properties, but there were no signs of a large-scale discontinuity that could be traced to the introduction of the new formula. And, finally, although liability insurance costs certainly rose rapidly, the contrary behavior of the change in other elements of operating cost apparently kept the insurance cost growth from being translated into growth in total operating expenses.

CHAPTER 5

MAINTENANCE AND REINVESTMENT IN THE RENTAL HOUSING STOCK

Introduction

The impact of rent stabilization on maintenance and reinvestment in the housing stock have been among the most important issues wherever regulation of rent levels has been attempted. The reasons for this are straightforward, but the determination of the actual effects is very complex. This section of the Report first discusses the reasons why maintenance and reinvestment may be affected by rent stabilization, and then examines the evidence on the nature and size of the impacts in Los Angeles.

It is often argued that if owners' rental revenues are significantly constrained by rent stabilization, their response will be to reduce housing quality to match the permissible rent levels and maintain rates of return. Given the nature of housing, there are only limited ways in which this can occur, principally through the reduction of operating expenditures. Costs such as taxes and mortgage interest payments are fixed, at least in the short term. Utilities, waste removal, and insurance similarly cannot be easily adjusted by building owners, although measures such as individual metering may shift these costs from

owners to tenants over time. Immediate reductions in expenditures can most easily be made by cutting day-to-day operating expenditures for maintenance or deferring or reducing planned investments in major subsystem replacement or upgrading. In consequence, almost all rent control or stabilization ordinances have provisions intended to prevent the reduction of services in buildings or to encourage continuing maintenance and reinvestment.

These measures are not enacted solely to ensure that regulation provides benefits for tenants. Housing is a capital stock that is very costly to construct in the first place and even more expensive to replace. Like any other capital asset that is not maintained, housing will deteriorate if it is not cared for, and its useful life may be shortened to a degree that is socially wasteful. The premature loss of substantial numbers of housing units, especially at the lower rent end of the spectrum, will give rise to serious social problems and high costs for society at large. It is therefore important to determine how rental regulation actually affects maintenance and reinvestment in any given urban area, and to what extent such effects are serious.

Although the logic of the response of maintenance to rental regulation is not difficult, measurement of the size and nature of the effects is extremely hard. This is true for two reasons. First, there are no generally agreed measures of housing quality. Should maintenance levels be measured by the physical condition

of the housing unit itself or by the level of maintenance expenditure that is made with respect to it? If physical condition is to be assessed, how should it be measured and who should do the measuring? How can such assessments be made comparable from one housing unit to another? These problems are so difficult that they have led the U.S. Census to cease collecting data on housing condition except for a few, objective indicators such as lack of indoor plumbing. On the other hand, the use of expenditure volume to measure maintenance may not reveal the real state of housing in the stock. Even if it did, where will such information come from? And, does it reflect a steady, rising, or falling state of housing quality in a housing stock that is changing over time?

To respond to these problems, this study addresses the issues of maintenance and reinvestment from several different points of view. The tenant survey described in Chapter 3 included questions about the physical quality of the units and the degree of tenant satisfaction with the levels of service received. These are subjective responses, but they were given by a large number of tenants and can be aggregated to reduce the influence of individual biases. These responses are compared to similar items from prior surveys taken before rent stabilization was enacted as well as during the period since it has been in effect. On the cost side, the Report draws on data for operating costs of housing in Los Angeles as reported by owners, again aggregating large numbers of individual cases and comparing them

over time. Finally, for reinvestment, the report draws on the records of the Rent Stabilization Division itself for estimates of reinvestment approved under the procedures in the Ordinance. None of these measures is precise in itself. Together, however, they provide a multiplicity of views on the issue, the sum of which can be regarded as reasonable and reliable.

Maintenance of the Housing Stock

The analysis of housing maintenance in this section deals first with the information from the survey of tenants and then with the evidence from owners. The former data principally look at maintenance and housing quality from the perspective of the physical condition of the housing unit and response to needs for repair. The latter information covers the expenditure side, looking at the proportions of total revenues and expenditures directed toward maintenance and operation of the housing.

Tenant Perceptions of Maintenance

Housing maintenance is something that most tenants are well aware of and concerned about. The survey therefore asked a series of questions to elicit information from tenants about their perception of the quality of the housing that they occupy and their satisfaction with its maintenance. Chart 5.1 below provides a summary of tenants' perceptions of four quite specific aspects of housing quality related to maintenance. Tenants were

asked whether their housing was in need of some repair, had inadequate plumbing or heat, or suffered from specific defects. It should be emphasized that the questions asked here referred to quite specific aspects of housing condition and maintenance, so the responses can be revised with some confidence. Furthermore, these questions were identical to those asked in surveys of tenants in 1977 and 1984, so that it is possible to see how these responses have changed over time.

CHART 5.1

INCIDENCE OF REPORTED MAINTENANCE PROBLEMS IN RENT STABILIZED HOUSING, LOS ANGELES, 1977, 1984, AND 1987

<u>Maintenance Problem</u>	<u>Incidence of Problems Percent of Units:</u>		
	<u>1977</u>	<u>1984</u>	<u>1987</u>
Inadequate Plumbing	1.4%	0.6%	1.3%
Inadequate Heat	10.8	10.0	5.8
Three or More Defects	1.6	7.0	7.4
In Need of Repair	12.5	15.6	12.9

Sources: 1977 Annual Housing Survey, HR&A, The Rent Stabilization System, and 1987 tenant survey.

The results shown in Chart 5.1 present a picture that is mixed but generally encouraging. The percentage of tenants reporting that their units are in need of repair fell in 1987 from over 15% in 1984 to just above the pre-stabilization level of 12.5% in 1977. We can assert with a high probability that the

fall from 1984 to 1987 is not due to sampling variability and that the 1987 level does not differ significantly from that of 1977.

The other three measures show a more diverse set of results. Inadequate plumbing was reported in only about 1% of housing units and its variation over the ten year period is insufficient to be statistically significant. The incidence of inadequate heat fell from about 10% of cases in 1977 and 1984 to just below 6% in 1987, a significant drop. Finally, the proportion of tenants reporting three or more specific defects, which had risen from 1977 to 1984, leveled off at about 7% in 1987, the small increase from 1984 being entirely within the range of sampling variability.

To provide some perspective on these data, Chart 5.2 presents the results of the same survey questions in 1987 when they were directed to tenants in non-stabilized housing built in Los Angeles between 1979 and 1987. Since these are newer units, we would expect the incidence of perceived inadequacies to be lower. The Chart shows that it is, but not by much. The overall estimate of units in some need of repair stood at 9% for these newer non-unstabilized units, as opposed to 13% for rent stabilized housing. As was to be expected, none of the newer units had lack of plumbing, but heat inadequacies and defects occurred at levels not very dissimilar from those for rent stabilized housing. Of course, it must be recognized that the nature of defects is

relative from the tenant's perspective. These responses cannot take account of differences in severity of defects. Nonetheless, they suggest that there are likely to be problems with housing of any type, whether subject to rent regulation or not.

CHART 5.2

INCIDENCE OF REPORTED MAINTENANCE PROBLEMS IN RENT STABILIZED AND UNSTABILIZED HOUSING, LOS ANGELES, 1987

Incidence of Problems:
Percent of Units:

<u>Maintenance Problem</u>	<u>Unstabilized Units</u>	<u>Rent Stabilized Units</u>
Inadequate Plumbing	0.0%	1.3
Inadequate Heat	4.0	5.8
Three or More Defects	6.3	7.4
In Need of Repair	9.0	12.9

What conclusions can be drawn from these data on perceived problems of maintenance? First, the 1987 survey indicates no dramatic impact of rent stabilization upon housing quality and maintenance as measured in this way. If anything, maintenance appears to be stable or even improving slightly. The fall in the reported percentage of housing units in need of repair is encouraging. It is also quite consistent with the nationwide increase in housing rehabilitation and reinvestment that has occurred during the period of economic growth since the end of the severe recession of the early 1980s. The Los Angeles housing market appears to be more affected by economic and demographic condi-

tions than any other factor. If rent stabilization has had an adverse impact, it is not detectable with this type of measurement.

This view is reinforced by the evidence of reported satisfaction on the part of tenants. Chart 5.3 provides a summary of results on tenant satisfaction with their housing conditions for 1984 and 1987. (Comparable questions were not asked in the national Annual Housing Survey conducted in 1977.) Four indicators of housing satisfaction relate closely to maintenance: physical condition, upkeep of the building, the speed of repairs, and satisfaction with the landlord. Close to 80% of tenants expressed themselves as satisfied with the physical condition and upkeep of their housing in 1987, a proportion essentially identical to that in 1984. This result is quite consistent with the responses about specific aspects of maintenance discussed above. On the other hand, substantially more tenants expressed dissatisfaction with both their landlord and the speed of repairs than was the case in 1984. By 1987, close to one-third of all tenants in rent stabilized units reported dissatisfaction. In each instance the shift was large enough to be unlikely to be caused by sampling variability.

These somewhat inconsistent patterns pose some questions about the way in which housing is being supplied in the rent stabilized stock. In particular, they suggest that rent stabilized housing is not under sufficient financial pressure to

result in major deficiencies in maintenance, but that tenants' relations with landlords may be deteriorating. The causes of such a deterioration do not seem to lie in housing quality itself, which suggests that it is necessary to explore other aspects of the situation of renters in the City.

CHART 5.3

TENANT SATISFACTION WITH QUALITY AND MAINTENANCE OF RENT STABILIZED HOUSING, LOS ANGELES, 1984 AND 1987

Percent of Tenants Satisfied:

<u>Housing Quality Indicator</u>	<u>1984</u>	<u>1987</u>
Physical Condition	79%	80%
Upkeep	77	78
Landlord	75	70
Speed of Repair	70	66

One clear feature of rent stabilization that emerged in the 1985 study was the very high incidence of benefits received by tenants who had been in their housing at or before the initiation of rent stabilization in 1978. At that time, it was also noted that dissatisfaction with housing tended to increase with length of tenure. The 1987 study makes it possible to test this observation after three more years of rent stabilization. Chart 5.4 presents the percentage of tenant respondents who indicated that they were dissatisfied with the physical condition, the upkeep of their units, the speed of repairs, or the landlord, cross tabulated with the length of their tenure in their housing.

CHART 5.4

TENANT DISSATISFACTION WITH MAINTENANCE OF RENT STABILIZED
HOUSING, BY LENGTH OF TENURE, LOS ANGELES, 1984 AND 1987

<u>Length of Tenure</u>	<u>Percent of Tenants Dissatisfied With:</u>							
	<u>Physical Condition</u>		<u>Upkeep</u>		<u>Speed of Repair</u>		<u>Landlord</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
Less Than One Year	15%	16%	17%	15%	24%	33%	16%	24%
One to Three Years	20	15	22	21	31	30	23	33
Three to Six Years	21	24	23	26	31	35	21	31
Over Six Years	20	21	22	22	30	34	25	31
All Tenants	20	21	22	22	30	34	25	31

Several striking features emerge from this Chart. In 1987, as in 1984, dissatisfaction rises with length of tenure over all four characteristics of housing quality. However, in 1987 this increase is more pronounced, indicating a widening gap in satisfaction between those with shorter and longer tenures. Paradoxically, tenants with longer tenure and presumably higher benefits from the existence of rent stabilization are likely to be more, rather than less, dissatisfied than other tenants. As time passes they seem to be growing more dissatisfied. This tendency is observable across all four characteristics, but it is most strongly pronounced in the cases of dissatisfaction with speed of

repairs and with the landlord. Furthermore, dissatisfaction on these two dimensions seems to have increased by a substantial degree across tenants of almost all lengths of tenure.

Why this should be the case is not immediately evident. The evidence on satisfaction with physical condition and upkeep suggests that major changes in maintenance may not be the primary cause. Nor is it the burden of rent. Chart 5.5 presents comparable data on dissatisfaction arrayed against the level of rent-to-income ratio of the tenants. It exhibits no clear pattern of change across time and only a modest indication of increasing dissatisfaction with increases in rent burden.

CHART 5.5

TENANT DISSATISFACTION WITH MAINTENANCE OF RENT STABILIZED HOUSING, BY RENT-INCOME RATIO, LOS ANGELES, 1984 AND 1987.

<u>Rent-Income Ratio</u>	<u>Percent of Tenants Dissatisfied With:</u>							
	<u>Physical Condition</u>		<u>Upkeep</u>		<u>Speed of Repair</u>		<u>Landlord</u>	
	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>	<u>1984</u>	<u>1987</u>
Less Than 20%	19%	20%	21%	22%	29%	35%	27%	29%
20% - 30%	22	20	23	23	34	31	27	30
30% - 40%	20	17	21	23	31	39	41	37
Over 40%	27	21	27	24	41	36	27	33

One possible explanation may be a growing perceptual dissonance between the expectations of tenants in older buildings who compare the services received today with those that they may have received in the past. Another explanation may be that owners are differentiating in their treatment of tenants between those who have moved in more recently and pay higher rents and those with lengthy tenure and lower rents. However, in order to attract the more recent movers at higher rents, owners must still maintain their buildings, which would account for the perception by all tenants that upkeep has worsened little if at all.

The tenant survey data suggest that rent stabilization continues to have relatively little effect on housing maintenance overall. Although satisfaction with landlords and speed of repair has decreased, concern about physical condition of housing and upkeep has scarcely changed since 1984. Indicators of specific problems of maintenance have tended to fall since 1984, in some respects returning to pre-rent stabilization levels. In the next section of the Report, the level of expenditures is examined in order to assess whether these conclusions are supported by information from another source.

Outlays on Maintenance

Analysis of outlays on maintenance depends critically on the availability of information. As previously indicated, only two usable sources of data exist on outlays for maintenance in rental

housing in Los Angeles. They are the Institute of Real Estate Management's (IREM) annual surveys for the metropolitan area, and the analysis of owners rents and operating costs based on tax returns and prepared for the Rent Stabilization Division by the State of California Franchise Tax Board (FTB).

The primary source for this section of the report is the FTB data, shown below in Chart 5.6, which deal directly with the rent stabilized stock. The IREM information will be used for comparative purposes, however. The final column in Chart 5.6 shows the percentage change in five of the major expense categories between 1984 and 1986 for rent stabilized buildings in the City as a whole. Also shown on the Chart are the percentages of total net operating expense accounted for by each of these categories, which together accounted for more than 60% of total operating expenses.

Chart 5.6 indicates that cleaning and maintenance expenditures increased by less than either rents or costs as a whole, though they remained a constant percentage of total expenses, at about 5% in 1984-86. The expenditure share for repairs declined from 19.3% in 1984 to 17.2% in 1986, while the percentage increase in repair expenses during this period was 7.6%, substantially less than the 20.8% increase for all operating costs. Although the FTB expense data suggest that expenditures for repairs are lagging behind operating expenses, this conclusion should be considered tentative because the shift in repair ex-

penses may reflect year-to-year fluctuations in capital improvements that were recorded as expense items for tax purposes. However, given the possibility of a decline in repair expenditures, the FTB expense data should be carefully monitored in future reviews of the RSO.

CHART 5.6

DISTRIBUTION AND CHANGES IN SELECTED COMPONENTS OF OPERATING EXPENSES, RENT STABILIZED HOUSING, LOS ANGELES, 1984-1986*

<u>Expense Category</u>	<u>Percent of Net Operating Expense</u>			<u>Percent Change in Expense</u>
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1984-86</u>
Cleaning and Maintenance	5.5%	4.8%	5.3%	15.4%
Repairs	19.3	N/A	17.2	7.6
Insurance	8.1	9.1	9.8	46.6
Taxes	16.2	16.0	16.5	23.4
Utilities	17.4	17.4	15.7	9.0
Net Operating Expense	100.0	100.0	100.0	20.8

SOURCE: Franchise Tax Board data.

* Not all expense categories are included, therefore totals do not add to 100.0%.

As might be expected from the special review at the end of the preceding Chapter, the most rapid growth occurred in insurance expense, which increased by 47% in the period, to almost 10% of total expenses. Taxes increased at a somewhat faster rate than the average of expenses as a whole, but utilities grew much more slowly, reflecting the fall in oil, gas, and electricity prices. Overall, the impression given by the data is that maintenance and repairs were barely keeping pace with other expenses, with the latter rising more rapidly. This is quite consistent with the pattern of modest increases in dissatisfaction revealed by the survey of tenants. However, the differences in the collection period of the FTB data (1984-6) and the survey (1987) should make one cautious in drawing any strong inferences.

Chart 5.7 provides a picture of these same categories of expenditure by size of building. It shows that the changes in maintenance expenditures were quite uneven.

In small buildings, with two to five units, both rents and expenses increased by less than the Citywide average, at 15 and 19% respectively. Cleaning and maintenance, in contrast, increased rather more than the average, this effect being offset by lesser growth in other categories. Although insurance costs rose sharply, by 31%, their increase was still less than average, as was the case for repairs, taxes and utilities.

CHART 5.7

DISTRIBUTION AND CHANGES IN SELECTED COMPONENTS OF OPERATING
EXPENSES OF RENT STABILIZED HOUSING, BY BUILDING SIZE,
LOS ANGELES 1984-1986*

Building Size and Expense Categories	Percent of Operating Expense Percent			Change in Expense **
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1984-86</u>
<u>2 - 5 Units</u>				
Cleaning and Maint.	4.8%	4.5%	4.7%	18.0%
Repairs	21.9	N/A	20.8	13.1
Insurance	9.3	10.2	10.2	31.3
Taxes	17.2	17.0	17.0	17.5
Utilities	12.7	13.4	11.5	8.0
Net Op. Expense	100.0	100.0	100.0	19.0
<u>6 - 11 Units</u>				
Cleaning and Maint.	5.6	4.9	5.0	(2.9)
Repairs	19.9	N/A	17.1	(6.5)
Insurance	7.5	8.4	9.5	37.6
Taxes	15.9	16.0	16.4	12.6
Utilities	18.6	18.7	17.3	1.3
Net Op. Expense	100.0	100.0	100.0	9.0
<u>Over 12 Units</u>				
Cleaning and Maint.	6.6	5.1	6.3	36.4
Repairs	14.5	N/A	13.1	27.7
Insurance	7.2	8.6	9.7	89.7
Taxes	15.0	14.6	16.0	51.2
Utilities	22.4	21.8	18.7	18.5
Net Op. Expense	100.0	100.0	100.0	41.9

SOURCE: Franchise Tax Board data.

* Not all expense categories are included, therefore, percentages do not add to 100.0%.

** Change in expenses are calculated from the cost per unit of the various expense categories.

Buildings in the moderate sized category, 6 to 11 units, displayed a very different pattern. Both rents and costs rose by much less than the Citywide averages, though rents did exceed costs in their growth. Maintenance and repairs declined, and only insurance rose sharply. The larger buildings, with over 12 units, exhibited still another quite different pattern. Operating expenses those rose much more steeply than maintenance and costs, by 42% as compared to 33%. All expense categories increased faster than the Citywide average, with insurance leading at almost 90%. Taxes also rose rapidly, probably reflecting turnover in ownership. Nonetheless, maintenance and repair expenses generally held their own, suggesting that the quality of upkeep was not declining.

These variations among buildings of differing sizes are striking and difficult to explain fully. They do suggest that policy in rental regulation should be sensitive to variations in the economics of building size, and they may indicate that moderate sized buildings deserve some special attention.

The FTB data, as suggested above, provide a picture of only the rent stabilized housing stock. But, some comparisons with the larger market may be drawn from the IREM samples, although they cannot be compared directly owing to differences in the expense categories employed. Chart 5.8 shows the rate of increase for IREM operating expense categories and relative impor

tance of each to total operating cost. Net operating expenses for the IREM buildings grew by 24% in the 1984-86 period, which is 3% more than the percentage recorded by FTB.¹

CHART 5.8

DISTRIBUTION AND CHANGE FOR SELECTED COST COMPONENTS IN IREM BUILDINGS, LOS ANGELES METROPOLITAN AREA, 1978-1986*

<u>Expense Category</u>	<u>Percent of Operating Cost: (Median Percent)</u>					<u>Percent Change in Operating Cost</u>	
	<u>1978</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1984-6</u>	<u>1978-86</u>
Maintenance and Repair	26.9%	26.9%	27.2%	26.8%	27.4%	12.8%	100.0%
Insurance	5.3	4.9	5.7	5.4	7.2	64.3	187.5
Real Estate Taxes	20.4	10.7	10.4	9.3	9.4	19.2	0.0
Operation and Utilities	20.4	24.2	24.1	22.3	21.2	(0.0)	100.0
Net Operating Expense	100	100	100	100	100	23.8	105.7

Source: Institute for Real Estate Management annual surveys.

* Percentages for expense categories do not add to 100% because not all categories are included.

¹IREM presents its data in terms of median square foot income and costs for each of four different building types. Consequently, the parts do not necessarily sum to 100%. The median values reported in this chart were derived by weighting the values reported by IREM for eight building categories. The weights are based on the number of buildings in each category.

Since the categories are not identical to those in the FTB analysis, direct comparisons are limited. Nonetheless, comparison of maintenance and repair expenditures are possible when the two are grouped together. In 1986, maintenance and repairs accounted for about 27% of net operating expenses in IREM buildings. That level had remained fairly stable over a ten year span, but it was slightly more than the 23 to 25% cost share reported in the FTB sample. Part of the difference may be definitional, although the four expense categories shown in Chart 5.8 account for about the same percentage of net operating expenses as the five FTB categories in Chart 5.7. Over the 1984-86 period, IREM maintenance and repair expenses increased by 128%, which is just 3.4% more than the 9.4% growth in the combined category of cleaning/maintenance and repairs shown in the FTB data.¹ In addition, IREM expenditures for repairs and maintenance lagged increases in all operating costs by 11%, which is consistent with the 13% lag found in the FTB data. Since the IREM data include unstabilized units in its sample, this similarity suggests that the lag in maintenance and repair expenditures reflects the underlying structure of the rental housing market, rather than the effects of the RSO. Insurance is the fastest growing expense in both data sets, but its growth rate is greater in the IREM data than in the FTB data.

¹The 9.4% growth rate is the weighted average of the 15.4% growth rate for cleaning and maintenance and the 7.6% growth rate for repairs as reported in Chart 5.6.

Comparison of the IREM and FTB data presents problems that are both technical and definitional. Thus, only limited inferences may be drawn. If the data are accepted, however, then maintenance and repair expenses have been rising at a lower rate than operating expenses in both the stabilized and unstabilized rental housing stock.

Reinvestment in Rental Housing

Preservation of a viable housing stock requires not only maintenance but also reinvestment as major housing subsystems wear out and break down. In this context, we define reinvestment to mean infrequent and substantial capital expenditures that either replace worn out or obsolescent major subsystems, or substantially upgrade the physical quality of housing.

Because of this double meaning, reinvestment has an ambiguous significance in relation to rent stabilization. On one hand, it is absolutely necessary to retain habitable housing in the stock, and in so doing to preserve housing at a lower cost than any equivalent replacement. On the other hand, reinvestment may signal an owner's recognition that the potential market for a property has changed. If higher income tenants are being attracted to an area, then upgrading buildings may allow an owner to replace less affluent tenants with those who can pay more. Gentrification, then, becomes financially attractive, and, to take advantage of it, owners will reinvest in buildings to make

them more attractive. The result can be partial or complete displacement of the occupants of a neighborhood. Thus, ordinances regulating rents almost always regulate the rent increases that are permitted in a building as a result of reinvestment. The process of administering such limits is often convoluted, reflecting the tension between the desire on the part of regulatory agencies to preserve and improve the housing stock in specific ways and their simultaneous determination to prevent upgrading that creates major tenant displacement.

The Rent Stabilization Ordinance in Los Angeles has provisions for rent adjustments in response to reinvestment that generally seek to encourage physical replacement without tenant displacement. Although there is also a provision for major rehabilitation that does allow a unit to be deregulated completely, the cost levels of doing this are high and the tenants must be compensated. By far the largest part of capital improvement activity under the Ordinance is concerned with replacement that gives rise to relatively modest rent increases.

Evidence of Reinvestment

No complete analysis of housing reinvestment activity in Los Angeles is possible at this time. As in the 1985 study, we will utilize two sources of information to perform a partial analysis: (1) records of applications for rent increases under the capital improvements provision of the Rent Stabilization Ordinance; and

(2) responses of tenants to survey questions about capital improvements in their buildings. Neither of these sources permits an estimate of the total level of reinvestment in the housing stock. But, they do allow us to explore the question of whether the level of reinvestment recorded by the various indicators has been rising or falling.

The Los Angeles Rent Stabilization Ordinance permits rent increases in recognition of capital improvements and renovation, with a provision for total deregulation of units upon substantial renovation. The latter has stringent requirements and is little used. The former applies to replacements and improvements that have at least a five year life. Items included under this capital improvements provision range from smoke detectors to new roofs.

Rent increases for capital improvements are calculated on the basis of a five year amortization of costs. Once given, such rent increases become a permanent part of the rent base for future adjustments. In order to receive a capital improvement rent increase, an owner must apply and submit documentation of the expenditure. This requires some effort and may be complicated for some owners, but in comparison with comparable regulatory requirements elsewhere the Los Angeles process is not onerous. Nevertheless, it probably does screen out some very small improvements, and may inhibit small owners or those with language difficulties.

Data on the volume and approval rate for capital improvement applications appear in Chart 5.9. During the nine years since the program was begun, over 21,000 applications have been processed, an average of 2,341 per year. The number of applications has not varied greatly from year to year, although it did peak in 1981 and 1982. This probably reflects the undoubted fact that inflation was substantially greater than the annual rent adjustment at that time, so that owners were desperately seeking ways to increase rents. Since 1984, applications have levelled off at about 2,300 annually. Of these, the great majority are approved, the rate exceeding 95% in recent years. Over time, the approval rate has risen, suggesting that owners have learned how to deal with the process. Given the high level of approvals, it is perhaps surprising that more owners have not applied. Still, there can be no doubt that the number of buildings undergoing reinvestment in any year is much higher than 2,000.

CHART 5.9

CAPITAL IMPROVEMENT APPLICATIONS AND APPROVALS IN THE RENT
STABILIZATION SYSTEM, LOS ANGELES, 1979-1987

<u>Year</u>	<u>Applications</u>	<u>Approvals</u>	<u>Approval Rate</u> (Percent)
1979	1,008	850	84.3%
1980	2,195	1,935	88.2
1981	2,854	2,631	92.2
1982	2,857	2,430	85.1
1983	2,412	2,195	91.0
1984	2,661	2,410	90.6
1985	2,504	2,450	97.8
1986	2,277	2,267	99.6
1987	2,305	2,233	96.9
Total	21,073	19,401	92.1

Source: Estimated from Rent Stabilization Division records.

The total and average value of investment as a result of capital improvements are shown in Chart 5.10 below. About 3% of the 70,000 registered buildings recorded capital improvements each year. A specific building may be associated with more than one application, so the total number of buildings shown in the Chart does not equal the number of applications. The most striking feature of Chart 5.10 is the rapid increase in the value of capital improvements since 1983. In five years, the total value has more than doubled to over \$27 million, and the average per building has exhibited a similar rate of growth. At a time when

the rate of inflation has been moderate, this growth is impressive. By 1987, the program had cumulatively accounted for over \$121 million of investment. These are large numbers, but in comparison with the 70,000 buildings registered under rent stabilization and their probable needs for reinvestment, they may account for only a small percentage of the need.

CHART 5.10

CAPITAL IMPROVEMENT VALUE AND NUMBER OF BUILDINGS, RENT STABILIZATION PROGRAM, LOS ANGELES, 1979-1987

<u>Year</u>	<u>Total Approved Investment (\$)</u>	<u>Number of Buildings</u>	<u>Average Investment</u>
1979	\$3,133,228	793	\$3,591
1980	8,089,151	1,726	4,687
1981	10,939,698	2,244	4,875
1982	14,969,359	2,246	6,665
1983	10,297,052	1,896	5,431
1984	12,213,326	2,252	5,423
1985	14,737,082	2,300	6,407
1986	19,713,161	2,122	9,290
1987	27,147,738	2,165	12,539
Total	\$121,239,795	17,744	\$ 6,833

Source: Estimated from Rent Stabilization Division records.

Capital improvements imply investment, but they also involve rent increases. In Chart 5.11, the impact of the program on housing units and rents is displayed. Apart from the extraordinary level of 1982, the number of units affected by capital improvements under rent stabilization has fluctuated around 26,000 annually. In 1987, this amounted to just under 5% of the 478,700 registered units, reflecting the tendency of the program to attract owners of larger buildings who can understand and afford the process. The allowable rent increases resulting from these improvements have grown with the value of improvements, from an average of \$6.22 per month in 1978 to \$11.06 in 1987. However, not all allowable rent increases are in fact put into place. For units that are under lease or already at market rents, owners may not be able to raise the rent. Similarly, units occupied after the capital improvement application are not permitted a further increase. In consequence, the actual rent increases following capital improvements may be less than those allowed, especially until leases expire.

CHART 5.11

ALLOWABLE RENT INCREASES DUE TO CAPITAL IMPROVEMENTS, RENT
STABILIZED HOUSING, LOS ANGELES, 1979-1987

<u>Year</u>	<u>Number of Housing Units Receiving Rent Increase</u>	<u>Average Allowable Rent Increase* (\$ per month)</u>	<u>Total Allowable Rent Increase (\$ per year)</u>
1979	8,400	\$6.22	\$ 626,976
1980	29,199	4.62	1,618,793
1981	24,468	7.45	2,187,439
1982	43,133	5.78	2,991,705
1983	26,274	6.54	2,061,984
1984	25,377	8.01	2,439,237
1985	22,300	5.25*	1,477,668
1986	26,331	8.98	2,828,508
1987	27,768	11.06	4,181,861
Total	233,259	7.10	20,415,748

Source: Estimated from Rent Stabilization Division records.

* The 1979-84 figures showing the actual approved monthly rent increase were calculated by dividing all units into total improvement value. However, about one-quarter of the units in an average building receive improvements without increases since they are already at market value. The 1985-87 numbers are derived from the actual total monthly rent increase for units actually receiving increases.

Capital improvements have been made at a relatively constant rate since 1979, while the cost per improvement has risen over this period. Nonetheless, they constitute less than one-third of the total capital improvements that would normally have been required during the nine years of rent stabilization.¹ The

¹A simple calculation of the number of new roofs that would be

evidence on maintenance and quality of the housing stock and the need of owners to keep up their property in order to rent vacancy decontrolled units suggests that these improvements have probably been made and financed from rent increases associated with turnover.

A further indication of this is provided by the tenant survey. Tenants were asked whether any major improvements to their buildings had occurred since 1978, or since they had moved in. Although major improvement was not fully defined in the question, thus requiring caution in interpreting the responses, a substantial proportion of the respondents indicated that improvements had occurred. Chart 5.12 shows the proportions of tenants who reported improvements according to the types of building in which they lived. About one-third of all tenants responding said that an improvement had been made. This proportion was slightly less than that reported in the 1984 study, but the difference was minor. The incidence of reported improvements did not vary greatly by type of building, although high rise apartments apparently had fewer improvements.

necessary for a stock of 70,000 buildings, assuming a 20 year roof life, indicates that about 3,500 should be reroofed each year. The capital improvements process generates fewer than 1,000 applications for roofs annually. Since roofs are among the most expensive items, other improvements are unlikely to generate a higher proportion of applications.

CHART 5.12

MAJOR IMPROVEMENTS REPORTED BY TENANTS IN RENT STABILIZED HOUSING, LOS ANGELES, 1987

Percent of Tenants Reporting:

<u>Building Type</u>	<u>Major Improvement</u>	<u>No Improvement</u>	<u>Not Sure</u>	<u>Total</u>
2 - 4 Units	36.7	57.0	6.3	100.0
Garden Apt.	33.2	61.4	5.4	100.0
Low Rise	42.4	52.2	5.4	100.0
High Rise	25.9	68.2	6.0	100.0
All Buildings	33.7	60.8	5.5	100.0

Source: HR&A, 1987 Tenant Survey

Note: Percentages may not add to 100 due to rounding.

CONCLUSION

Despite the problems in measuring the extent and quality of maintenance and reinvestment in the housing stock, there is no evidence to suggest that the major conclusions of the 1985 report have been changed by the experience of the past three years. The impact of rent stabilization on housing maintenance in Los Angeles has been and remains slight. Both maintenance and reinvestment have continued to occur. While tenant dissatisfaction with owners' performance has risen, especially with regard to the speed of response to complaints, tenants remain satisfied with the general condition and maintenance of their buildings. The single greatest concern would be any sustained indication that costs of operation and rent increases were diverging, which could pose a problem for the future. However, this is an issue that cannot be fully determined with the information available at this time. It deserves careful observation during the coming years.

CHAPTER 6

THE PROBLEM OF HISTORICALLY LOW RENTS

Some building owners have asserted that the Rent Stabilization Ordinance is causing a serious problem in buildings in which most of the tenant population pay what they term "historically low rents." In directing that this issue be examined in detail, the City Council's Government Operations Committee described it as a problem "experienced by landlords of smaller properties who have units which are still at very low rent levels since the enactment of the Rent Stabilization Ordinance."¹ The assertion is that, as a consequence of historically low rents, landlords operating many smaller rental buildings are failing to earn reasonable rates of return on their investments, and that in the long run deterioration and abandonment of these properties will occur.² Since about half (51%) of the stabilized housing units in Los Angeles are in buildings with ten or fewer units, it is important to evaluate this issue carefully. If many of these

¹See the Governmental Operations Committee Report, File No. 85-2289, June 30, 1987, p.1.

²The term "smaller rental properties" is not precisely defined by the Governmental Operations Committee. For the purposes of this report, smaller rental properties are buildings with ten or fewer units. In the analysis that follows, buildings are categorized as follows: 1) 1 unit; 2) 2 - 5 units; 3) 6 - 10 units; 4) 11 - 20 units; 5) 21 - 49 units; and 6) 50 or more units. This categorization allows the reader to easily consider their own definition of small buildings.

buildings are in fact chronically unprofitable because of historically low rents, the long-run adverse consequences to the City's stabilized housing stock could be substantial.

In order to analyze the incidence and probable impact of historically low rents, the essential propositions of the landlords' argument were identified by reviewing documents presented by them and others at public meetings of the Government Operations Committee and the Rent Adjustment Commission, and through individual interviews with owners who reported experiencing the effects of such rents.¹ Then, each element of the assertion and the available empirical evidence bearing thereon was evaluated.

This section begins with a discussion of the genesis of historically low rents and the derivation of five essential propositions that those who see them as a major problem assert. The empirical analysis of these propositions follows, including the results of a special supplemental survey of properties identified by their owners as burdened by historically low rents.

¹We are grateful to owner Clarence Liles for his discussion and for providing us with the various documents he has prepared, which are used here to develop the essential propositions describing what owners believe is the evolution of the problem of historically low rents.

The Asserted Origins Of Historically Low Rents

The building owners asking the Council for relief from this problem argue that it was created by the following set of circumstances. At the time the Rent Stabilization Ordinance was adopted by the City Council in 1979, they say, many owners of small rental properties were charging below-market rents in a spirit of generosity to their tenants. Resident owners were even more likely than others to have charged below-market rents, given their close personal contact with their tenants. And, not being sophisticated property managers, the argument goes, such small "mom and pop" owners often did not take advantage of the provision in the Ordinance that enabled them to increase rents by between 13% and 19% at the point that it took effect in 1979 if they had not raised rents in the preceding one to two years, respectively.¹ Consequently, the stabilized rent base with which these property owners began in 1979 is argued to have been artificially low, so that all allowable increases made since under either the 7% flat ceiling or the CPI-based ceiling have failed to make the buildings financially productive.

The theory underlying the Ordinance, of course, is that a problem of this kind will be resolved by tenant turnover, with rents raised to market by the landlord each time that each unit

¹See Section 151.06.A and 151.06.B of the RSO. These sections also allowed for an additional one to two percent, onetime increase if the landlord paid for gas, for electricity, or for both (i.e., a 1% increase for each).

is vacated. However, the petitioning landlords argue that smaller buildings are much more likely than larger ones to house long-staying tenants who have never vacated their units since the advent of rent regulation. In addition, they argue, a large percentage of these long stayers are what the 1985 study called "unintended beneficiaries" of the Ordinance, which they believe was not intended to provide benefits to tenants with incomes over \$40,000 per year unless they were elderly. The petitioning landlords note (correctly) that roughly 25% of the long stayers identified in 1984 had annual household incomes in excess of \$40,000, and that most of these households were not headed by elderly persons.¹

In summary, this argument asserts that buildings suffering from historically low rents both started out with an artificially low rent base and then failed to experience the gradual equilibration to market that was intended to result from vacancy decontrol. Thus, while owner operating costs increase more rapidly than revenues, unintended beneficiaries are alleged to be reaping windfall benefits at the expense of small property owners. The outcome of this scenario, according to these owners, is accelerated deterioration of the rental units in small buildings and fire sale prices for small rental buildings sold to opportunistic buyers. At its extreme, this process leads to

¹According to the 1984 tenant survey, approximately 14% of the long-staying households with more than \$40,000 in annual income were headed by persons of more than 62 years of age.

abandonment, once these buildings have been fully depreciated for tax purposes and deteriorate because of systematic undermaintenance.

The historically low rents argument incorporates a number of critical propositions that can be tested using the 1984 and 1987 Tenant surveys. And, because of the City's concern about this problem, an additional special survey of tenants was also conducted in 50 buildings which landlords identified as experiencing such rent patterns.

The testable factual propositions in the landlords' argument are the following:

-- At the time the RSO was adopted, many small property owners were charging below-market rents.¹

-- Tenant turnover rates are significantly lower in smaller buildings because the characteristics of the tenants found in such buildings differ systematically from those found in larger properties.

¹A corollary to this proposition is that smaller property owners were less likely to take advantage of the adjustments allowed to landlords who had not increased rents during the two years preceding adoption of the RSO.

-- The problem of increasing operating costs in the face of stabilized rent rolls and long stayers has led to declining financial performance in these buildings.

-- Declining financial performance leads to reductions in maintenance levels which has lowered the quality of rental units in smaller buildings.

-- Many of the "long stayers" who are the primary beneficiaries of the RSO have relatively large incomes and are not elderly, making them unintended beneficiaries of the RSO.

The available evidence bearing on each of these propositions is presented and its implications are analyzed in the subsections below.

1. The Incidence of Below-Market Rents in Small Buildings

The proposition that the rents charged by many small property owners at the time the RSO was adopted were "below market" can be evaluated from several perspectives. The definition of what constitutes a "below-market rent" is itself an issue, since rents charged prior to the adoption of the RSO were in fact determined in a competitive market. A quite respectable technical case can be made that the rents then being charged were by definition at market levels. This case would hold that any differential that may have then existed between rents in smaller buildings and

those in larger buildings reflected either (i) unfortunate timing of the 1978 rent freeze in the time cycle of rent adjustments (e.g., annual, biennial) practiced by a particular landlord with respect to a particular unit, or (ii) some combination of different physical characteristics among buildings of various sizes and the willingness of small building landlords to give up some margin in rent in return for certain characteristics in their tenant population (e.g., long- rather than short-term average tenancies and resultingly infrequent interruption in rental income from each unit).

If accepted, this position would immediately dismiss virtually the whole of the historical rents argument. The Ordinance contained a specific technique (i.e., the aforementioned one time adjustment of 13 - 19%) for dealing with anomalies in the relation between the timing of the freeze and the rent adjustment timing cycles used by particular landlords. If all other pre-stabilization prevailing rents were taken to be at market levels by definition, the only remaining shard of the historical rents argument would be an assertion that smaller, less sophisticated building owners were given insufficient opportunity to learn of the permissible onetime adjustment. In view of the power of the proposition that the only true definition of a market rent is a rent set by an unregulated market, there is an

extremely heavy burden of proof on the advocate who asserts that such a rent is in fact "below-market" in any technically sustainable sense.¹

Despite the considerable force of this argument, however, an analysis was performed based on the hypothesis that any systematic differential in the rents charged to the longest staying households in stabilized housing which could be shown to correlate systematically with differences in the size of the buildings in which they resided would be considered evidence that below-market rents had been charged in earlier years and continued to be charged in 1987.² (Because all units continuously occupied since the RSO was adopted were allowed the same maximum percentage annual rent increases, and it is reasonable to assume that any landlord suffering the asserted problems would have imposed

¹Note that systematic altruistic behavior, of which the generosity claimed on the part of the owners of small buildings is an example, is just as much a market feature as is profit maximization. The fact that such behavior may have occurred does not mean that the individual or average rents that then emerged were "below-market." To the extent that one accepts the assertion that any margin between the pre-stabilization rents that were actually charged in small buildings and those that could have been realized was caused by true altruism, as against landlord trade-off of monthly rent in return for benefits of other types, this simply means that the market included altruistic as well as profit-maximizing behavior in arriving at the rents charged. Those rates would still be properly called "market rents" in conventional technical usage.

²Other characteristics of the unit that may affect rents, such as the number of bedrooms, were held constant statistically in this analysis.

the maximum increase allowed by law, any "below-market" differential created when the RSO was adopted should have been carried forward to the 1987 survey data.)

In order to identify any such below-market rent differentials empirically, a rent index was created which controlled for size of unit, presence of a resident owner, and continuous occupancy since the RSO was adopted.¹ The model describes the positive or negative value associated with various attributes of housing and the tenure characteristics of the occupants, while holding the effects of other variables constant. For example, the age of the building typically exhibits a negative relationship to rents (i.e., older buildings command lower rents), while the number of bathrooms in a unit will have a positive relation to rent. The values concerned with unit size permit measurement of any rent premiums or discounts that may relate to the number of units in a building. Most important, the model identifies any systematic deviations in 1987 rents charged to households with nine or more years of tenure according to the number of units in the building.

¹The specification of what constitutes below-market rent was based on the model used in Chapter 3 (and in the 1985 study) to estimate tenant benefits from rent stabilization. This model compares current actual rents, as reported by tenants, with market rents, defined as the rents which would exist if the tenant tenure discounts characteristic of the pre-stabilization year of 1977 were still in effect, rather than the quite different tenure discounts which have developed under stabilization. The hedonic index employed is described in detail in the Technical Appendices.

Note that if such an analysis found only that significant negative values were associated with buildings of fewer than 11 units, this finding alone would not confirm the below-market rents proposition in the owners' argument. Such other factors as amenities found only in larger buildings could account for a general negative differential for all tenants in smaller vs. larger buildings that was unrelated to below-market rent differentials established in 1979. Therefore, the analysis must be further refined, as described above, to determine whether any rent discount or premium that may exist is related both to the number of units in the building and to the tenants with nine or more years of tenure. Only this relation can confirm that the differential in rent is related to the below-market phenomenon that the argument asserts.

The results obtained when the model was applied, using the data collected in the 1987 tenant survey data are summarized below in Chart 6.1.¹

CHART 6.1

DISCOUNTS/PREMIUMS IN AVERAGE MONTHLY STABILIZED RENT RELATED TO BUILDING SIZE, AND TO LONG STAYING TENANT HOUSEHOLDS IN BUILDINGS OF VARIOUS SIZES, 1987

(All comparisons are to rents in buildings with 50+ units.)

Monthly Rent Discounts by Size of Building

2 - 5 units	-\$80*
6 - 10 units	-\$85*
11 - 20 units	-\$68*
21 - 49 units	-\$59*

Monthly Premiums/Discounts to Long Staying Tenant Households (9+ Years) By Building Size

2 - 5 units	\$40
6 - 10 units	-\$5
11 - 20 units	-\$4
21 - 49 units	\$52

* Significant at the .001 confidence level. All figures which are not asterisked tested statistically as not significantly different from zero.

[NOTE: Negative figures are discounts below average rents in building of more than 50 units; positive figures are premiums above those average rents. The data base for these calculations consisted solely of those tenant responses which provided all of the information necessary for regression analysis. This base was somewhat smaller than the full body of responses.]

¹The coefficients for all variables in the model are contained in the Technical Appendices, as are the results of statistical tests of the capability of the model to draw significant distinctions. The dependent variable in the model is monthly contract rent.

The results reported in the Chart suggest that in 1987 there was a statistically significant difference in average rents between buildings containing more than 50 units and those of smaller size, and that rents in smaller buildings were systematically lower. The difference ran \$80-85 per month in buildings with 10 or fewer units. However, the results do not indicate that there was any systematic difference related to the incidence of long staying households within buildings of different sizes. No variation from zero along this axis proved statistically significant by standardized tests.¹ And, as shown in the Chart, the variations that did appear depicted long staying households in the smallest buildings as paying an actual average premium above rents in very large buildings, while those in the second and third smallest category realized very small discounts.

In sum, the results received from the model do not support the contention that smaller stabilized rental properties (or large ones, for that matter) were systematically rented to long

¹The tests were repeated using larger size subgroups to be certain that the absence of statistical significance in the differences was not an artifact of small numbers of small buildings containing long staying households in each of the original subgroups. Once again, the differences recorded for the larger subgroups also did not test as significant. This means that the variation among the rents charged to long stayers in the member buildings of each subgroups was too great to discern any systematic pattern of difference according to building size.

stayers at below-market rates in 1978.¹ Some specific properties may, of course, have been so rented, but there is no evidence in the results of a systematic tendency for buildings of any size to rent to long stayers at lower rates at the time the RSO was adopted.

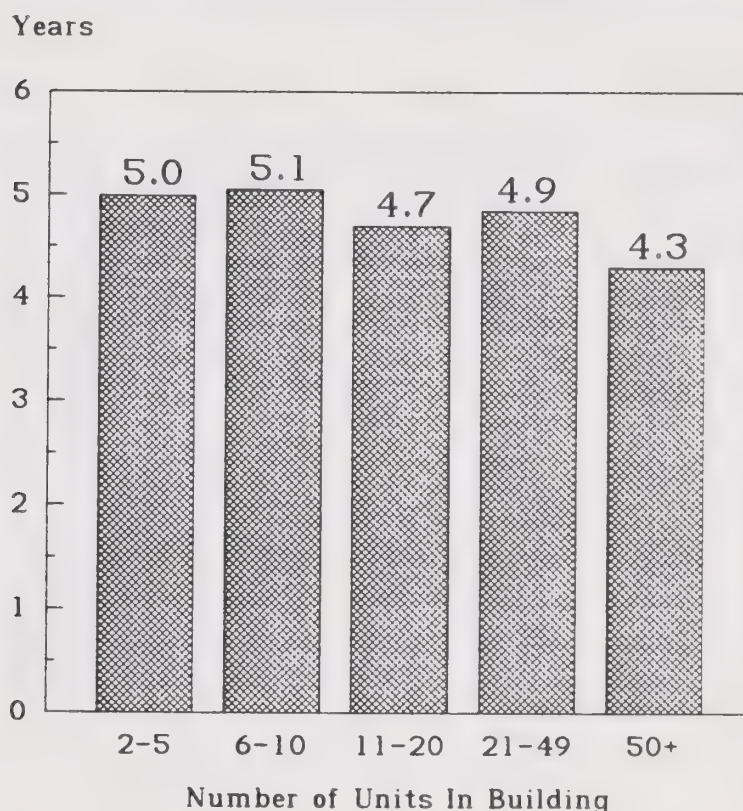
2. The Incidence of Lower Tenant Turnover in Small Buildings

The proposition that turnover rates in small buildings have been systematically lower than in larger buildings can be evaluated both descriptively and analytically. Starting with the descriptive approach, Chart 6.2 shows the average tenure of tenants by number of units in the building.

¹The residuals were classified by building size and examined to determine if there was a systematic underprediction of rents by building size. This form of underprediction would support the existence of below-market rents, but the residual analysis indicated that there was no such systematic underprediction.

CHART 6.2

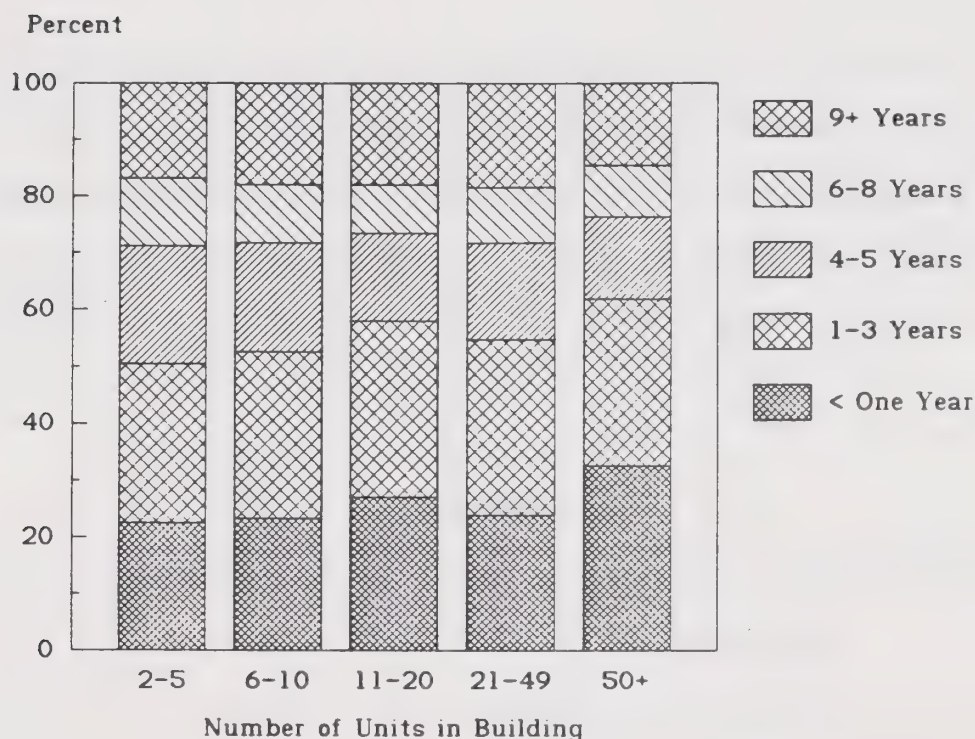
AVERAGE TENURE IN UNIT, BY NUMBER OF UNITS
IN BUILDING: 1987



The data in the Chart indicate that, while there are slight differences in tenure by building size, only buildings with more than 50 units had a significantly lower average tenure in 1987 -- 4.3 years versus 5.0 years -- than buildings with two to five units.

Chart 6.3 shows the average tenure subgroup distributions of tenants, categorized by number of units in the building.

CHART 6.3

TENANT TENURE DISTRIBUTION BY NUMBER OF
UNITS IN BUILDING: 1987

These data indicate that the percentage of long stayers was essentially constant in 1987, at roughly 18%, for buildings containing between six and 49 units. It was actually slightly lower (16.8%) in buildings of 2-5 units, and more substantially lower (14.6%) in buildings with 50 or more units. In addition, buildings with 50 or more units were slightly more likely to have occupants with less than one year of tenure than were smaller buildings, although there were virtually no differences among most subgroups of smaller buildings in this regard. These results suggest that, although there may be some validity to the claim that smaller buildings have longer average tenure rates -- and, therefore, lower average rates of turnover -- the differ-

ences are not dramatic and they effectively differentiate between buildings of more than 50 units and all other buildings, not among buildings of various sizes smaller than 50 units.

The same data summarized in Chart 6.3 can be used to estimate the statistical likelihood of particular tenure distributions of long stayers within buildings. These probabilities are shown by number of units in a building in Chart 6.4 on the following page. (A probability of 1.0 equals 100%, or absolute certainty.)

CHART 6.4

PROBABILITY OF "LONG STAYERS" TENANTS BY NUMBER OF UNITS IN BUILDING
ASSUMING POPULATION PROPORTIONS

Number of Units With <u>Long Stayers</u>	<u>Buildings With:</u>					
	<u>2 Units</u>	<u>3 Units</u>	<u>4 Units</u>	<u>5 Units</u>	<u>10 Units</u>	<u>20 Units</u>
0	0.67	0.55	0.45	0.37	0.14	0.02
1	0.30	0.36	0.40	0.41	0.30	0.08
2	0.03	0.08	0.13	0.18	0.30	0.17
3		0.01	0.02	0.04	0.17	0.23
4			0.00	0.00	0.07	0.21
5				0.00	0.02	0.15
6					0.00	0.08
7					0.00	0.04
8					0.00	0.01
9					0.00	0.00
10					0.00	0.00
11						0.00
.						0.00
.						0.00
.						0.00
20						0.00
<u>Sum of Probabilities</u>	1.00	1.00	1.00	1.00	1.00	1.00

As the Chart shows, the probability that a duplex would be occupied by two long stayer households was three in one hundred, while the probability that neither of the households in a duplex would be long stayers was two out of three. Since the overall proportion of long stayers in the population was low, at less than 18%, the probability that an entire building would be occupied by long stayers fell rapidly with building size. Thus, for a building with ten or more units, the probability that all units would be occupied by long stayers was zero. At the same time, since larger buildings have more units available for occupancy by long stayers, the probability of no long stayer occupants in such a building declined as building size increased. These probabilities indicated that it was unlikely for large numbers of buildings of any size to be occupied entirely by long stayers in 1987.

Estimates of the actual number of buildings occupied by long stayers support this conclusion, as shown below in Chart 6.5.¹ These estimates indicate that, out of 37,099 buildings ranging in size from 2-20 units: 426 duplexes, 43 triplexes, and ten four-plexes were probably occupied entirely by long stayers, while the majority of these buildings were occupied by either one or no long stayer households. And, no buildings with five or more units

¹These estimates were made using the probabilities presented in Chart 6.4, the building size proportions obtained from the survey data, and the count of stabilized units registered in 1987.

are estimated to be entirely occupied by long stayers, although these buildings were likely to have more than one long stayer household.

CHART 6.5

ESTIMATED NUMBER OF BUILDINGS OCCUPIED BY LONG STAYING HOUSEHOLDS,
BY NUMBER OF UNITS IN BUILDING, 1987

Number of Units With Long Stayers	Buildings With:					
	2 Units	3 Units	4 Units	5 Units	10 Units	20 Units
0	10,438	5,238	6,193	992	312	19
1	4,215	3,173	5,002	1,002	690	85
2	426	641	1,515	405	686	178
3		43	204	82	404	234
4			10	8	156	219
5				0	41	154
6					8	84
7					1	37
8					0	13
9					0	4
10					0	1
11						0
.						0
.						0
.						0
20						0
TOTAL	15,079	9,095	12,925	2,489	2,298	1,029

Of course, the method of estimation used to generate the estimates in the Chart implicitly assumes that all buildings are occupied by tenants who track the average likelihood of being a long stayer. Since groups of households with tenure rates that deviate from the average may in fact congregate in a building, the estimates made above may understate or overstate the probability of occupancy by long stayers, as well as the likelihood that an entire building would be occupied by long stayers.¹

¹The probability of occupancy by long stayers may be overestimated by this method in instances where buildings are mostly or en-

Nevertheless, the available evidence indicates that this clustering effect would need to be very pronounced indeed in order to alter the basic direction in which that evidence points. This direction is toward the conclusion that turnover rates may be slightly higher, on average, in buildings with fewer than 50 units than in larger buildings, but not much higher, and that the probable incidence in the stabilized stock of small buildings rented entirely or predominantly by tenants with more than nine years of tenure in their units was quite low in 1987.

3. Incidence of Reduced Financial Performance in Smaller Buildings

The owners' assertion of increasing operating costs in the face of stabilized rents covering large numbers of long stayers suggests that the financial performance of smaller buildings should be declining relative to larger buildings. This proposition may be evaluated using the FTB data, which allow analysis of financial performance by number of units in building.²

tirely occupied by households with below average long stayer likelihoods; i.e., less than .18.

²The IREM data are not usable for this purpose since they do not include any buildings with fewer than 12 units. Also, the IREM data include information on units in unstabilized buildings as well as stabilized ones, whereas the FTB sample contains stabilized units only. However, it should be remembered once again that, since the FTB data reflect tax information only from individual owners and not from corporations or partnerships, these data tend to under represent larger buildings.

Chart 6.6 on the following page provides FTB data describing, by building size, the average rents and operating expenses per unit, the building's expense ratio, and its net operating income.¹ Although these data show that the financial performance of rental properties did vary by building size, there is no strong evidence that historically low rents were reducing the financial performance of smaller buildings relative to larger properties.

¹These data are also discussed more generally in Chapter 4.

CHART 6.6

AVERAGE RENTS AND EXPENSES PER UNIT, BY BUILDING SIZE, RENT STABILIZED HOUSING, LOS ANGELES: 1984 - 1986

<u>Average Value of Financial Indicator:</u>				
<u>Building Size</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>Percent Change</u>
<u>2 - 5 Units</u>				
Rent Per Unit	\$3,409	\$3,696	\$3,925	15.1%
Expense Per Unit	1,421	1,543	1,649	16.0
Expense Ratio	41.7%	41.8%	42.0%	--
NOI	1,988	2,153	2,276	--
NOI (1986\$)	2,138	2,220	2,276	6.5
<u>6 - 11 Units</u>				
Rent Per Unit	3,858	3,999	4,303	11.5
Expense Per Unit	1,228	1,487	1,643	33.8
Expense Ratio	36.9	37.2	38.2	--
NOI	2,630	2,512	2,660	--
NOI (1986\$)	2,828	2,590	2,660	(5.9)
<u>12 and Over Units</u>				
Rent Per Unit	3,774	4,157	4,598	21.8
Expense Per Unit	1,503	1,509	1,848	23.0
Expense Ratio	39.8	36.3	40.2	--
NOI	2,271	2,648	2,750	--
NOI (1986\$)	2,442	2,730	2,750	12.6

SOURCE: Franchise Tax Board.

The Chart shows that the average expense ratio for all buildings, regardless of size, increased between 1984 and 1986, with the increase in buildings of six to 11 units' larger than the rise in either larger or smaller buildings. The reasons for this differential are not readily apparent.¹ However, given similar increases in the expense ratio for the smallest and largest buildings, the FTB data do not support an assertion that historically low rents have impaired the relative financial performance of the smallest buildings. The deteriorating financial performance of buildings with six to 11 units also appears unrelated to historically low rents since smaller buildings were not experiencing similar decreases in expense ratios.

However, the data in Chart 6.6 also indicate that buildings with two to five units had higher expense ratios than larger buildings. Historically low rents could possibly account for the differences in expense ratios between buildings with two to five units and buildings with 12 or more units. But, since the expense ratios for buildings with six to 11 units were smaller than either of the expense ratios for the smaller and larger building size classes, this explanation seems improbable.

¹The above average increases in expense ratios for buildings with 6 to 11 units may reflect a movement towards the expense ratios of the other size classes, since the expense ratio for all buildings with 6 to 11 units was roughly 3 to 5% below the expense ratios for the other size classes in 1984.

Similarly, the per unit NOI data indicate that the smallest buildings did not perform as well as the larger buildings -- \$2,276 per unit in 1986, versus \$2,660 and \$2,750 for the 6 to 11 unit and 12+ unit buildings, respectively. But, real NOI per unit increased 6.5% for buildings with two to five units, while it decreased by 5.9% for buildings with six to 11 units, and by 12.6% for buildings with 12 or more units. Although the disparity in financial performance between the smallest and the largest buildings suggests the possible influence of historically low rents, the deterioration in financial performance of buildings with six to 11 units relative to buildings with two to five units once again makes this explanation improbable.

4. Reduced Maintenance and Deterioration of Housing Quality in Smaller Buildings

Owners next argue that the presence of tenants paying historically low rents in smaller buildings leads to lower housing quality when maintenance expenditures are cut back in response to the inadequate rent base. This possibility can be evaluated using the FTB tax return data for maintenance and repair expenses, together with the tenants' self-reported assessment of various indicators of housing quality. Collectively, these indicators suggest that in 1987 problems of substandard maintenance and lower housing quality were no more likely in smaller buildings than in large buildings. Although one set of ten-

ant-assessed housing quality indicators suggests smaller buildings may be of lower quality, all other indicators suggested otherwise.¹

The cleaning, maintenance and repair expense data obtained from the FTB are shown on the following page in Chart 6.7, calculated on a per-unit basis.²

¹The analysis that follows is subject to the general qualifications on housing maintenance monitoring and analysis that are stated in Chapter 5. In addition, this analysis is limited, since it cannot account for other factors that may create differences in maintenance and housing quality by building size that are unrelated to historically low rents, such as the age and design of the structure.

²These data were discussed from a different perspective in Chapter 5. This Chart is an excerpt from Chart 5.7, which shows not only maintenance, but other expenses, by building size.

CHART 6.7

DISTRIBUTION AND CHANGES IN SELECTED COMPONENTS OF OPERATING EXPENSES OF RENT STABILIZED HOUSING, BY BUILDING SIZE, LOS ANGELES: 1984-1986

	Operating Expense						
	1984		1985		1986		1984-86
Building Size and Categories	%	Per Unit	%	Per Unit	%	Per Unit	Percent Change in Expense
<u>2 - 5 Units</u>							
Cleaning & Maintnce.	4.8%	\$ 64	4.5%	\$ 65	4.7%	\$ 76	18.0%
Repairs	21.9	294	N/A	N/A	20.8	333	13.1
Subtotal	26.7	358	N/A	N/A	25.5	409	14.0
Net Operating Expense:	100.0	\$1,346	100.0	\$1,453	100.0	\$1,601	19.0
<u>6 - 11 Units</u>							
Cleaning & Maintnce.	5.6	80	4.9	73	5.0	78	(2.9)
Repairs	19.9	214	N/A	N/A	17.1	266	(6.5)
Subtotal	25.5	364	N/A	N/A	22.1	344	(5.8)
Net Operating Expense:	100.0	1,430	100.0	1,493	100.0	1,559	9.0
<u>Over 12 Units</u>							
Cleaning & Maintnce.	6.6	89	5.1	73	6.3	122	37.1
Repairs	14.5	196	N/A	N/A	13.1	251	28.1
Subtotal	21.1	284	N/A	N/A	19.4	374	31.7
Net Operating Expense:	100.0	1,360	100.0	1,435	100.0	1,929	41.9

SOURCE: Franchise Tax Board.

[NOTE: All expense categories are not included, therefore percentages do not add to 100.0% nor do the per unit costs add to total operating costs.]

These data indicate that, while there were differences by building size in expenditure levels for maintenance and repair work, there was little support for the notion that smaller buildings were poorly maintained.¹ First, in absolute terms, the smallest buildings tended, on average, to spend as much or more per unit on maintenance and repairs as the largest buildings. For example, in 1986 owners of buildings with two to five units reported expenditures of \$409 per unit, as compared to \$344 and \$374 for buildings with six to 11 units and 12 or more units, respectively. Second, the share that spending for maintenance and repairs as a percentage of operating expenses for the smallest buildings tended to be equal to or greater than the share for the largest buildings. Thus, in both absolute and percentage terms smaller buildings were spending as much or more on repairs and maintenance as larger buildings, which suggests that systematic under-maintenance of smaller buildings was probably not occurring.

The percent changes in the levels of expenditures for maintenance and repairs between 1984 and 1986 are also shown in Chart 6.6. These data provided a less clearcut picture of the differences in maintenance expenditures by building size. Between 1984 and 1986, maintenance and repair expenses for the smallest buildings (those with two to five units) increased by 14%, which was

¹These differences in operating expenses may be attributable to economies of scale, the age of the structure and other factors not directly related to historically low rents.

less than the overall increase of 19% in operating expenses. For buildings with more than 12 units, maintenance and repair expenses have increased by 31.7% as compared to 41.9% for all operating expenses. In buildings with six to 11 units, maintenance and repair expenses declined absolutely between 1984 and 1986, from \$364 per unit to \$344 per unit. In percentage terms this spending declined by 5.8%, while operating costs increased by 9%.

These data do not lend themselves to easy interpretation, given the complex relationships exhibited across building size categories and in the absence of a data series longer than three years that might suggest systematic long-term differences in maintenance costs. But, the fact that maintenance and repair costs lagged total operating costs for all building size categories from 1984 to 1986, not just in smaller buildings, does not support the hypothesis that historically low rents in smaller buildings are leading to reduced maintenance and declining building quality.

A somewhat different perspective is gained by examining the tenant responses, arrayed by building size, to inquiries concerning two specific measures of housing quality: inadequate heat and the presence of three or more defects in the unit. These responses are summarized below in Chart 6.8.

CHART 6.8

TENANT ASSESSMENTS OF HOUSING QUALITY BY
NUMBER OF UNITS IN BUILDING: 1987

<u>Number of Units</u>	<u>Inadequate Heat</u>	<u>Three or More Defects</u>
2 - 5	7.7%	8.8%
6 - 10	4.7	8.0
11 - 20	5.8	5.8
21 - 49	4.4	7.6
50+	4.4	3.8

The first measure of poor quality addressed in the Chart, inadequate heat, was defined as the use of only a fireplace or stove for heating, or the absence of any form of heating.¹ The responses indicates that 7.7% of the smallest buildings (two to five units) had inadequate heat, or roughly twice as many as larger buildings with 21 or more units. Since this measure may reflect longer-term capital investment decisions made prior to the adoption of the RSO rather than more recent maintenance decisions, its reliability as an indicator of the effects of historically low rents is somewhat suspect.

¹The measure of inadequate plumbing discussed in Chapter 2 is not considered here since it is more an indicator of the vintage of the unit and absence of capital improvements than an indicator of ongoing maintenance decisions.

However, the other indicator of housing quality pointed in the same direction. This measure, the presence of three or more defects, was more closely tied to maintenance decisions and it also indicated that problems were roughly twice as likely in smaller buildings than in larger ones. The defects cited included conditions directly related to maintenance, such as exposed electrical wiring; the presence of holes in flooring, walls or ceilings; and broken or missing stair steps. This subjective indicator of several components of housing quality suggests that smaller buildings were more likely to contain lower quality housing units, a situation which could arguably be a consequence of historically low rents if one accepts the premise that rents set prior to stabilization could qualify as below-market.

When analysis of the behavior of these two quality indicators is taken to another level of sophistication, it appears that both are highly correlated to the age of the unit. When the analyst controls for the age of the building, these differences by building size disappear. Thus, any influence that may have been exerted by the phenomenon of historically low rents proved undetectable in the context of overwhelming influence of building age.

Yet another way to explore the relationship between building size and maintenance quality is to look at tenant satisfaction with overall housing upkeep and the speed of landlord repairs.¹

¹These data are also discussed more generally in Chapter 5.

These data appear below in Chart 6.9. Although tenant responses did vary by building size, they did not suggest that tenants in smaller buildings were systematically less satisfied with the upkeep of their building or the speed with which their landlord made repairs. Instead, the extent of tenants satisfaction varied somewhat randomly by building size, in contrast to the correlations with building size demonstrated by the two housing quality indicators treated earlier in Chart 6.7.

CHART 6.9

TENANT SATISFACTION WITH HOUSING, BY
NUMBER OF UNITS IN BUILDING, 1987

<u>Number of Units</u>	<u>Satisfied With Upkeep</u>	<u>Satisfied With Speed of Repair</u>
2 - 5	76.1%	67.8%
6 - 10	77.2	64.6
11 - 20	80.5	60.5
21 - 49	74.0	62.4
50+	80.5	75.5

As noted at the outset of this subsection, the housing quality data present a mixed bag with respect to the owners' historically low rents argument. Most of the available data do not support the proposition that housing maintenance has declined in smaller buildings, where these rents are alleged to have been concentrated, as against larger ones. But, the incidence of tenant reports of inadequate heat and of multiple defects in the unit do provide some support for systematically inferior quality conditions in smaller buildings.

5. Incidence of Unintended Beneficiaries in Smaller Buildings

The final proposition incorporated into the historically low rents argument is that an excessive number of "unintended beneficiaries" of rent stabilization reside in smaller buildings. According to the conventional understanding of the intent of the Ordinance, such beneficiaries would be limited to households with more than \$40,000 in annual income which are not comprised of elderly persons.

The proposition can be examined using simple descriptive statistics showing household characteristics by building size.¹ The characteristics that were recorded in the 1987 tenant survey include age and race/ethnicity of household head; household income; gross rent-to-income ratios; and household size. The only characteristics relevant to the issue of unintended beneficiaries are the age of the household head and the scale of household income. As will be seen below, neither of these two showed any systematic correlation with size of buildings. Indeed, of the five household characteristics examined, only two, race/ethnicity of household head and household size, displayed significant systematic variation by building size. Although the behavior of these two characteristics is not strictly relevant to

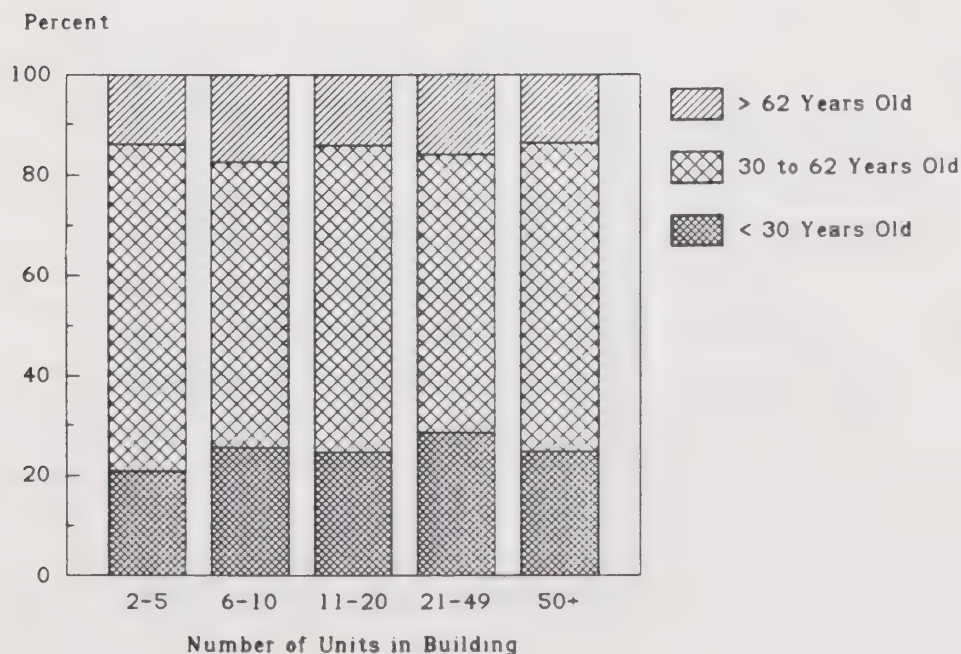
¹Since only 17% of the 1987 tenant survey sample consisted of long stayers, it is not possible to reliably describe the distribution of household characteristics by building size for long stayers only.

the issue of concentration of unintended beneficiaries, the pattern that they established is also presented for the information of the reader,

The distribution of age of household head by building size is shown below in Chart 6.10. These data show that there was only minor variation in the age distribution of household heads and no evidence that the variation was systematic. A comparison between the extreme size categories -- buildings with two to five units and buildings with more than 50 units -- suggests that there was no significant difference in the age distributions of the two groups of buildings.

CHART 6.10

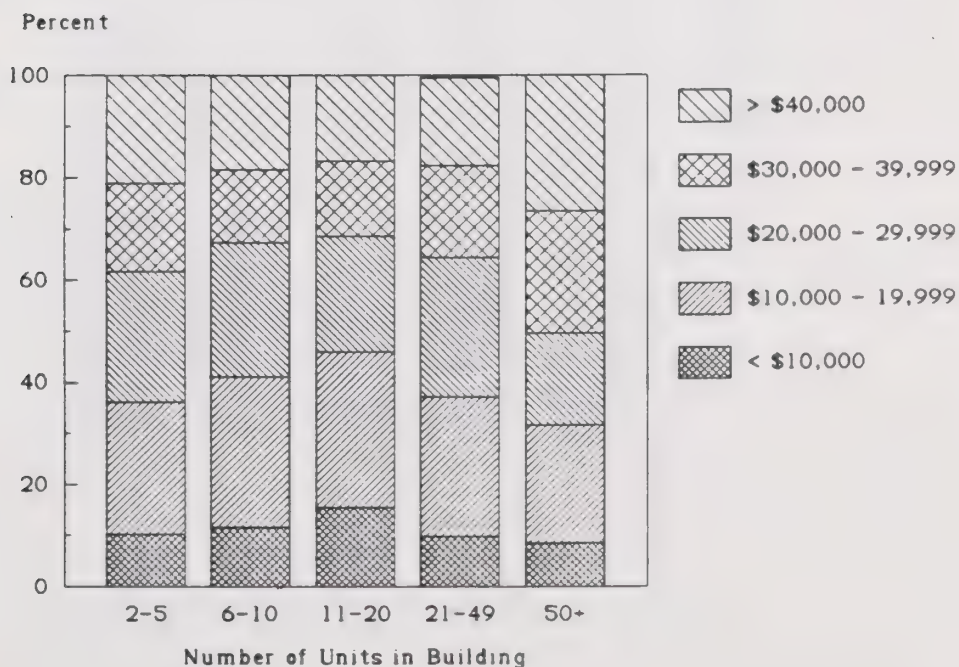
AGE OF HOUSEHOLD HEAD, BY NUMBER UNITS IN BUILDING: 1987



Household income distribution by building size is shown in Chart 6.11. These data show that, although there was some systematic variation in the income distribution by building size, the differences between the smallest buildings and the largest buildings were slight. In the range of intermediate building sizes, the number of lower income households (i.e., those earning \$20,000 or less annually) peaked in 11 to 20 unit buildings, and then gradually declined as size increased, down to a figure comparable with the smallest buildings. Similarly, the number of households earning over \$40,000 decreased with building size to its minimum in buildings with 11 to 20 units, and then increased to a figure comparable with the smallest buildings.

CHART 6.11

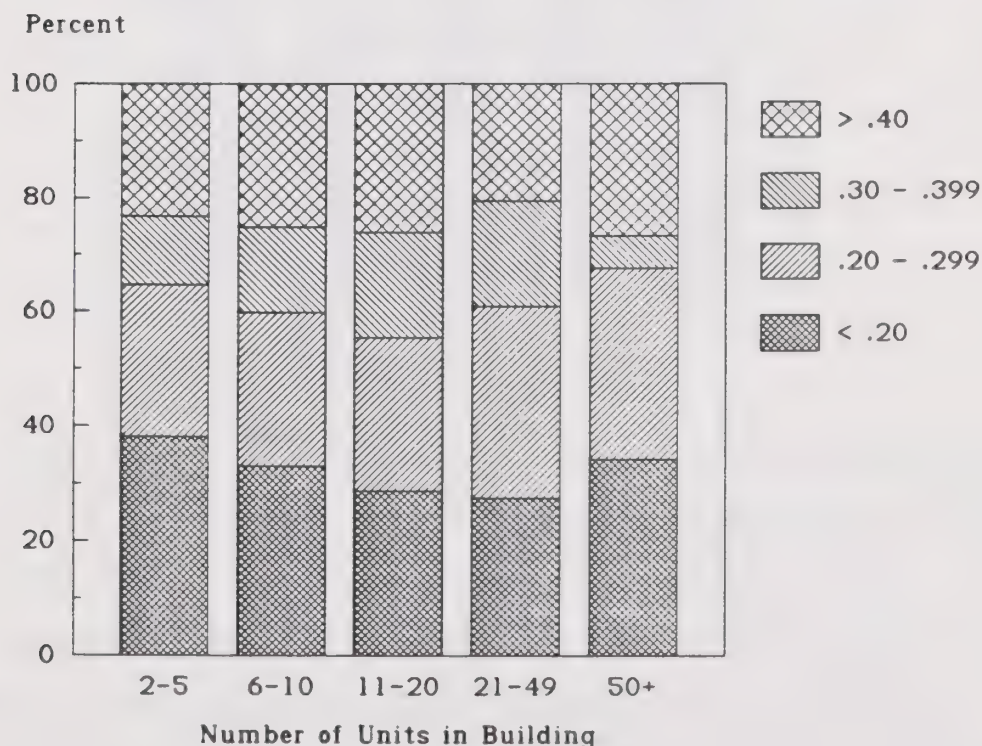
HOUSEHOLD INCOME DISTRIBUTION, BY NUMBER OF UNITS
IN BUILDINGS: 1987



The distribution of gross rent-to-income ratios by building size varied inversely to the distribution of household income, but the differences were not dramatic, as shown below in Chart 6.12. The percentage of households paying less than 20% of household income in rent was largest in the smallest and largest buildings, while the percentage of households paying more than 40% of household income towards gross rent was largest in buildings with 11 to 20 units. Since fewer low income households reside in the smallest and largest buildings, the relationship is consistent with the income data shown in Chart 6.11.

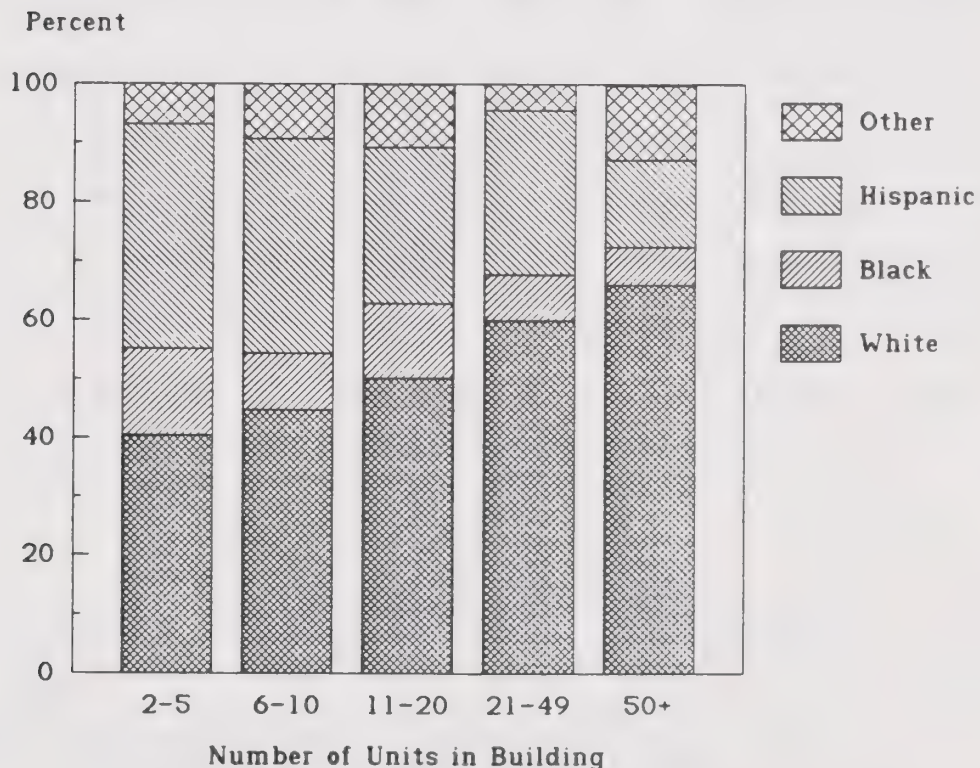
CHART 6.12

GROSS RENT TO INCOME RATIOS BY NUMBER OF UNITS: 1987



The racial/ethnic distribution of heads of household, by building size, is shown below in Chart 6.13. Unlike the preceding household characteristics, there were dramatic differences by building size.

CHART 6.13
RACE/ETHNICITY OF HOUSEHOLD HEAD, BY NUMBER OF UNITS IN BUILDING, 1987



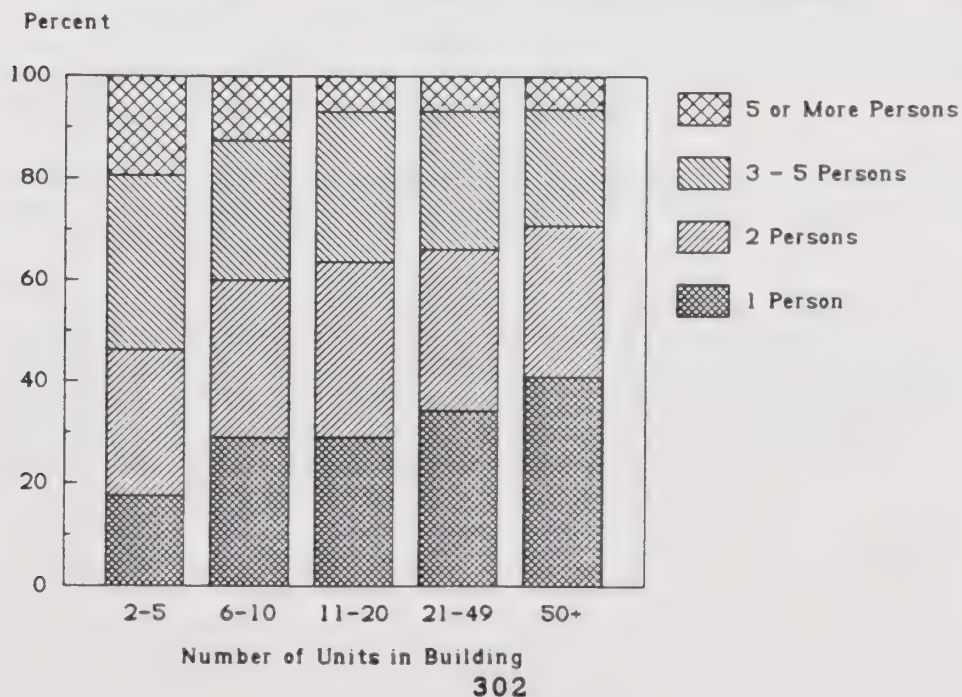
These data show that White-headed households averaged roughly 40% of units in the smallest buildings (two to five units) and 66% of the buildings with 50 or more units. Much of the difference in makeup by building size is accounted for by the different relative proportions demonstrated by Hispanic-headed households, which averaged 38% of the units in the smallest buildings, but only 15% of those in buildings with 50 or more

units. Meanwhile, the percentage of Black-headed households ranged from 15% in buildings with two to five units to 6% in buildings with more than 50 units.

The distribution of household sizes also varied substantially by building size, as shown below in Chart 6.14. These data suggest that smaller buildings were much more likely to be occupied by households of more than one person, while larger buildings were more likely to be occupied by one or, at most, two persons. Only 18% of the buildings with two to five units were occupied by one person households, as compared to 40% of the buildings with 50 or more units. Similarly, roughly 20% of the buildings with two to five units were occupied by households with five or more persons, which compares to 6% of the buildings with 50 or more units.

CHART 6.14

HOUSEHOLD SIZE, BY NUMBER OF UNITS IN BUILDING: 1987



In sum, if unintended beneficiaries of the Ordinance continues to be interpreted to mean non-elderly households with annual incomes of more than \$40,000, the 1987 tenant survey provided no evidence of concentration of such households in smaller buildings -- or in buildings of any other size, for that matter.

Degree of Empirical Support Discovered for Propositions Underlying the Historically Low Rents Argument

The review of empirical evidence documented above revealed little or no support for the five factual propositions that underlie the case for undue damage to owners of small buildings as a result of historically low rents. Specifically, it shows that:

- * Even if one accepts the questionable assertion that a rent arising from an unregulated market and subject to a one-time correction to remedy timing anomalies is still a below-market rent, there is no evidence of systematic charging of such pre-stabilization rents to households which have remained in their stabilized units in small (or large) buildings since the advent of rent stabilization.
- * The evidence suggests a slightly higher rate of tenant turnover in larger buildings as against smaller ones, but not a difference likely to create a widespread problem arising from historically low rents.
- * There is no evidence of a systematic differential in level of financial performance as between large buildings and small ones.
- * The bulk of the evidence indicates no systematic difference between large and small buildings with respect to maintenance problems, although there are some indications that smaller buildings provide lower average housing quality in terms of heating facilities and the existence of multiple defects as perceived by tenants.

* There is no evidence of the systematic difference in the average age of household head or in average household income in large vs. small buildings that might suggest unusual concentrations of "unintended beneficiaries" of rent stabilization in smaller buildings.

On the basis of the general statistical evidence collected in the course of this study, therefore, it must be concluded that the evidence does not support -- and in most cases tends to refute -- the propositions that comprise the argument that historically low rents are undermining the purposes of the Ordinance with respect to owners of small buildings. However, policy decisions should not be made solely on the basis of general statistics. In the aftermath of such an analysis, there remains a possibility that clusters of non-majority phenomena are being masked by the overall averages. For this reason, a special, supplemental survey of 50 buildings alleged to suffer from the problem was conducted. The results of this effort are reported in the section that follows.

Supplemental Survey of Tenants in Buildings with Historically Low Rents

To gain a better understanding of this phenomenon, two apartment owner organizations, the Apartment Owners Association of Greater Los Angeles, the Apartment Owners Association of Southern California, and the Apartment Association were asked by the RSD to produce a list of owners who felt that their buildings were experiencing the historically low rent problem. Forty-five building owners volunteered to participate in the study. In

total, they owned 93 buildings containing 881 units.¹ The addresses for these buildings were obtained from the RSD registration lists and through interviews with the property owners. Telephone numbers for all tenants with listed phone numbers were then obtained from reverse telephone directories.²

Like all surveys of this type, this one was limited by the enormous incidence of unlisted telephone numbers in Los Angeles, a proportion that reached 52.2% in 1986, the last year for which figures are available.³ In this instance, this generally high rate of unlistedness was substantially exceeded by the rate that the reverse directories indicated for the tenant households in these buildings.⁴ For these units, the reverse directories

¹It will be noted that the average building size was just under 10 units. Four of the properties in the sample were provided by a property management company rather than by an individual building owner.

²Depending on the area of the City, the reverse directories were current between April and December, 1987. These directories could not be used for sampling tenants in the Citywide study because of their inadequate reflection of recent tenant moves. However, since the historically low rent problem is asserted to occur because of tenants that are long stayers, this source should be accurate for tenants of this description who had listed telephone numbers.

³The 1986 figure was up from 48.8% in 1985. This is a problem that afflicts all telephone surveys which start from addresses, particularly in California, which is the nation's unrivalled leader in the incidence of unlisted telephones. These data on unlistedness are from Survey Sampling, Inc.

⁴Of course, it is possible that some number of the units in these buildings had no telephones. The generally low incidence of rent stabilized dwellings with no phones makes this unlikely to explain much of the shortfall in numbers, however.

yielded telephone numbers for only 240, or 27%, of the units in these buildings. Double checking of addresses and directories and other steps designed to increase this yield were unavailing.

All of the tenant telephone numbers that could be assembled were called. Tenant households were then contacted and interviews were conducted with those who agreed to cooperate. These interviews employed the subsection of the same questionnaire that had been administered Citywide which explored tenants' rent histories and perceptions of building upkeep and tenure. Primarily because of the paucity of tenant telephone numbers, but also because of a non-trivial incidence of tenant refusal to cooperate, responses were obtained from only 82 of the tenants, or 9.3% of the total number of households in the subject buildings. To supplement this sample, and in order to obtain 100% samples for a subset of the smaller buildings, a series of 44 face-to-face interviews was conducted at 11 of the buildings surveyed by phone. The face-to-face interviews yielded an additional 15 responses, boosting the total sample to 97, while also providing a 100% sample of four buildings totaling 16 units as well as sample percentages that exceeded 49% in seven other buildings.¹

Even with the addition of the face-to-face interview results, these data reflect only a small portion of the universe of units in these buildings and must be used with caution. How

¹Several responses obtained in the face-to-face interviews duplicated households already contacted in the phone survey.

ever, given that the owners themselves selected the buildings in question, and that the data include some full buildings and majority samples of others, they should be sufficient to elucidate the general order of severity of the problem.

This supplemental survey provided data that can be used to evaluate the historically low rents argument in two ways. First the household and tenure characteristics of the larger rent stabilized population, as measured by the 1987 tenant survey, can be compared to those found in the supplemental survey. Since the properties in the supplemental survey were selected on the basis of the owners' stated concern for the financial burden imposed by historically low rents, this comparison should provide a clear example of the differentiating effects of historically low rents as against the general experience of the stock of stabilized units. Second, since the supplementary data were collected at the building as well as the unit level, an analysis of differences between the buildings represented in the supplemental survey is possible. Thus, the possibility that long stayers tend to cluster within a building, rather than diffusing throughout the stabilized stock, can be evaluated in general terms, although it should be remembered that this building-level analysis is limited by the small sample size.

Characteristics of the Respondents to the Supplemental Survey

Chart 6.15 on the following page compares the household characteristics of tenants in the Citywide 1987 survey and those who participated in the supplemental survey centered on buildings where the problem of historically low rents was said to be concentrated.

CHART 6.15

CHARACTERISTICS OF TENANT HOUSEHOLDS IN THE CITYWIDE SURVEY
AND THE SUPPLEMENTAL SURVEY OF BUILDINGS ASSERTED TO HAVE
CONCENTRATIONS OF HISTORICALLY LOW RENTS, 1987

	<u>Citywide Tenant Survey</u>	<u>Supplemental Survey</u>
<u>Age of Household Head</u>		
< 30 years	25%	19%
30 - 61 years	60	55
< 62 years	15	26
Average Age	42 years	47 years
<u>Household Income</u>		
< \$10,000	11%	17%
\$10,000 - 19,000	27	28
\$20,000 - 29,999	25	17
\$30,000 - 39,000	17	15
> \$40,000	20	18
Average Income	\$25,931	\$23,352
<u>Race/Ethnicity of Household Head</u>		
White	49%	60%
Black	11	14
Hispanic	32	13
Other	8	13

These data indicate that the two tenant samples were similar along many dimensions of household characteristics, but that there were some differences that were consistent with the landlords' assertion of how buildings with historically low rents differ from the larger stabilized housing stock. These differences were also largely consistent with the characteristics typical of the long staying households who have been shown both here and in the 1985 study to be the prime beneficiaries of rent stabilization. Although the small sample size of the historically low rents survey increases the variability of the estimates, the most dramatic differences did test as statistically significant.¹

As to race/ethnicity, the percentage share of households headed by Whites increased sharply from 49% in the tenant survey to 60% in the supplemental survey.² Conversely, the percentage share of households headed by Hispanics decreased by two-thirds in the supplemental survey, from 32% to 13%.³ The percentage

¹The sample size probably also limited the identification of more subtle differences between the two samples.

²This difference tested as significant at the 95% level of confidence.

³This difference tested as significant at the 99% level of confidence.

shares of households headed by Blacks and by Other minority group members were a bit larger in the supplemental sample, but these differences did not test as statistically significant.¹

The other area of significant difference between the surveys was the age profile of household heads. The five-year difference in average age between the Citywide survey and the supplemental survey -- 42 for the former and 47 for the latter -- was a clear-cut distinction of considerable magnitude.² Collaterally, the enlarged percentage share of elderly households in the supplemental survey, 26% as against 15% Citywide, was the counterpoint to the smaller share of the supplemental survey households headed by persons under 30 (19%) than had been identified in the rent stabilized stock at large (25%). Given this difference in age profile, it is not surprising that the average tenure and the average percentage of long staying households were also greater in the supplemental survey. These differences in tenure are discussed in more detail below.

¹In addition, neither the differences in income profile nor in average income between participants in the two surveys tested as statistically significant.

²This difference tested as significant at the 99% level of confidence.

Characteristics of Units

As shown in Chart 6.16 on the following page, the characteristics of the occupied units in the supplemental survey are indistinguishable from the units described in the 1987 tenant survey. The median number of units per building was identical in both surveys, 10 units, and the difference in the average number of rooms per unit between the two samples was a miniscule one-tenth of a room. Although the distribution of units per building and rooms per unit differ slightly, these differences did not test as statistically significant. The only physical difference between the samples of any arguable significance was the fact that the supplementary sample contained no buildings of more than 50 units, which made up 10% of the Citywide sample.

CHART 6.16

CHARACTERISTICS OF OCCUPIED UNITS IN THE CITYWIDE TENANT SURVEY AND IN THE SUPPLEMENTAL SURVEY OF BUILDINGS ASSERTED TO HAVE CONCENTRATIONS OF HISTORICALLY LOW RENTS, 1987

	<u>Citywide Tenant Survey</u>	<u>Supplemental Survey</u>
<u>Number of Units</u>		
1 - 5	28%	26%
6 - 10	23	30
11 - 20	19	15
21 - 50	20	30
51 - 100	6	0
101+	4	0
Median Number of Units	10 units	10 units
<u>Number of Rooms</u>		
One	8%	11%
Two	14	16
Three	32	32
Four	30	11
Five	12	12
Six +	4	1
Average number of rooms	3.3	3.2

Differences in Rents and Rent-to-Income Ratios

Data on the rents and rent-to-income ratios reported by tenants in the general and the supplemental surveys are reported in Chart 6.17 below.¹

CHART 6.17

RENTS AND RENT-TO-INCOME RATIOS PAID BY TENANT HOUSEHOLDS
IN THE CITYWIDE SURVEY AND THE SUPPLEMENTARY SURVEY
OF BUILDINGS ASSERTED TO HAVE CONCENTRATIONS
OF HISTORICALLY LOW RENTS, 1987

	<u>Citywide Tenant Survey</u>	<u>Supplemental Survey</u>
Average Monthly Gross Rent	\$525	\$499
Average Gross Rent-to-Income Ratio	30.7%	28.8%
Distribution of Rent-to-Income Ratios		
< 20%	32.3%	33.9%
20% - 29.9%	28.6	30.8
30% - 39.9%	14.8	16.9
> 40%	24.4	18.5

¹Because of the reduced scope of the supplemental survey, the costs of gas and electrical services were not obtained from the respondents. Consequently, gross rents were imputed as the sum of contract rent plus \$33, which is the average monthly cost of gas and electrical service reported in the 1987 tenant survey.

Although the data presented in the Chart do suggest that tenants in the supplementary sample may have paid slightly lower rents and a slightly lower share of their incomes in rent, the differences were not large and none of them tested as statistically significant. Thus, it is impossible to conclude that the supplemental survey revealed any systematic difference between Citywide averages and those from the sample of buildings alleged to suffer from concentration of historically low rents. In any case, the differences between the samples in these respects were so small (i.e., a 5% difference in average gross rent and a difference of nine-tenths of one percent in rent-to-income ratio) that even if they had tested as significant they would not have suggested the presence of a systematic financial problem of major scale.

Tenant Tenure

The other tenant characteristic, beyond average rents and rent-to-income ratios, that is critical to the historically low rents argument is the average tenure of households in buildings said to suffer from concentration of such rents, as compared to average tenure in the rent stabilized population as a whole. These data are shown in Chart 6.18 below.

CHART 6.18

AVERAGE TENURE AND TENURE DISTRIBUTION IN THE CITYWIDE TENANT SURVEY AND THE SUPPLEMENTAL SURVEY OF BUILDINGS ASSERTED TO HAVE HIGH CONCENTRATIONS OF HISTORICALLY LOW RENTS, 1987

<u>Length of Tenure</u>	<u>Citywide Tenant Survey</u>	<u>Supplemental Survey</u>
Less than 1 year	25.8%	18.9%
1 to 2 years	29.4	24.5
3 to 5 years	17.6	9.4
6 to 8 years	9.9	15.1
Over 9 years	17.3	32.1
Average Number of Years	4.8	6.7

Viewed from the perspective of the historically low rents argument, the data displayed in the Chart tell a two-sided story. On the one hand, consistent with the landlords' position they indicate that the incidence of long staying households, meaning those that had been in their units since the start of rent stabilization, was roughly twice as high -- 32% as against 17% -- as in the general stabilized population. And, as that position would also maintain, recent movers were much less frequent in the supplemental survey, and the average tenure for respondents in the supplemental survey was 6.7 years, almost two years longer than the average of 4.8 years reported in the 1987 tenant survey. All of these data suggest that the buildings identified as plagued by the problem of historically low rents were in fact tenanted by households with longer average histories in their units than was true of the stabilized stock as a whole.

On the other hand, it remained true that more than two-thirds (68%) of the tenants in the buildings in the supplementary sample had moved since the advent of rent stabilization. For the supplementary sample of units as a whole (but not necessarily for those located in a given building), this implies that their owners had had the opportunity to raise rents to market levels on at least one occasion since then. In more than half the units (53%), this opportunity had arisen during the previous six years, and in 43% of the units it had arisen during the three years immediately preceding the survey.

Thus, although the supplementary survey data support the proposition that tenant households in the 93 buildings did tend toward longer tenure, they do not suggest that the incidence of long stayers in this sample was rampant, since roughly two-thirds of the respondents were not long stayers. Consequently, the tenure characteristics of the supplemental sample do not support the image of multitudes of stabilized rental properties filled to capacity with long stayer households which pay rents at far below market levels.

Nevertheless, these unit-based data do not eliminate the possibility of a clustering phenomenon masked by the averages even in the special supplementary sample. That is, it does not rule out the possibility that long stayer and recent mover households may, respectively, congregate in specific buildings, leav-

ing some properties filled with long stayers and others filled with recent movers. The incidence of this situation can only be ferreted out by means of building-based data.

Because the building-by-building data base assembled in the supplementary survey includes relatively few buildings (i.e., 11) where information is available from at least half of all the units in the structure, it can only be used to provide a very rough approximation of reality. However, it can establish the maximum incidence of buildings in the sample that contained nothing but tenant households that had been in place since the onset of rent stabilization. Beyond establishing this outer bound, the results of the supplemental survey are limited by its respondent sample size of 44 buildings, but this is nonetheless a sufficient base to test for the presence of a historically low rents problem of large magnitude.¹

Chart 6.19 below presents a breakdown of the buildings in the supplementary sample which contained responding tenants.² In reviewing the Chart, it should be carefully noted that this breakdown assumes that the tenure pattern represented by the responses from each building is representative of the overall

¹Although, as noted earlier, there were 93 buildings in the full sample of volunteering landlords, responding tenants were occupants of only 45, and the responses from one of these were too incomplete to be used in the analysis.

²The reader will recall that data generated by the Citywide tenant survey were entirely on a unit basis, not a building basis, so that there are no comparable Citywide data to present.

tenure pattern in the building, including households that did not respond. For the one-quarter of the buildings in the sample where information was collected from between half and all of the constituent units, this assumption was most valid. However, in some buildings the respondents added up to less than 10% of the units, and may or may not have constituted a pattern representative of the building as a whole. As a result, this analysis is most reliable in establishing the outer limit on the number of the respondents' buildings which were filled to capacity with members of any particular tenure subgroup by determining the presence in all others of members of at least one other subgroup. It is least reliable, on the other hand, as an indicator of the precise pattern of subgroups in the sample as a whole.

CHART 6.19

LONG STAYING HOUSEHOLDS AS A PERCENTAGE OF UNITS IN THE BUILDINGS
OF TENANTS IN THE SUPPLEMENTARY SAMPLE .

<u>Percent Long Stayers in the Building</u>	<u>Percent of Buildings</u>
0%	50.0%
1 - 50	27.3
50 - 99	6.8
100	15.9

The most striking datum revealed by the Chart is the fact that there were no long-stayer household respondents at all in fully half of the 44 buildings where respondents were located. If the pattern of responses in these buildings was remotely similar to that of the building as a whole, the historically low rents argument had no relevance whatever to them. At the other end of the spectrum, only 23% of the buildings contained respondents more than half of whom had been resident in their units since the beginning of rent stabilization, and in only 16% of these buildings were all of the responding households of this description.

This pattern does suggest that some clustering of tenant households according to tenure may have been occurring. But it also suggests a severe limitation on the number of buildings that are entirely or predominantly filled with long staying households, even in a sample of buildings specifically chosen by their owners as examples of concentration of historically low rents. The one thing that the supplemental survey made absolutely clear about the 44 buildings from which responses were received is that no more than 16% of them could possibly have been entirely tenanted by long stayers even if one assumes that all non-respondent households were identical in tenure status to those who did respond. To the extent that any of the non-responders was not a long stayer, this share of all long-stayer buildings would decline. Thus, 16% represents the maximum share of buildings in the respondent sample that could have been filled to capacity by long stayers.

Another angle on the clustering phenomenon is provided by limiting the buildings examined to the 11 where face-to-face interviews were conducted with all or a majority of the resident households. When this was done, the findings on this point were as shown in Chart 6.20 below.

CHART 6.20

LONG STAYERS AS A PERCENTAGE OF UNITS IN BUILDINGS
IN SUPPLEMENTARY SAMPLE WHERE RESPONDENTS COMPRISED
49% OR MORE OF TENANT HOUSEHOLDS, 1987

<u>Percent Long Stayers in the Building</u>	<u>Percent of Buildings</u>
0%	27%
1 - 50	55
51 - 99	18
100	0

As might be expected, since they reflected the situations of all or most of the households in each building rather than only a share of them, these data tended to cut down on the extremes (i.e., buildings composed entirely of members of a single tenure subgroup) at both ends of the spectrum. Still one-quarter of these buildings produced no responding households at all which had been present at the outset of rent stabilization. And 82% of them were more than half occupied by households which had not been in their units that long. Finally, none of these buildings were entirely tenanted by households that were present when the program began. Again, this subsample consisted of only 11

buildings, but the data it generated seemed to confirm the direction of the findings taken from the larger subsample of all buildings in which respondents to the supplementary survey resided.

Overall Conclusion on the Empirical Basis for the Argument of Harm Due to Concentrations of Historically Low Rents

Having reviewed both the study's general data base and a specialized base of owner-identified buildings for signs of major concentrations of historically low rents and resulting damage to owner finances and/or to the quality of the stabilized rental housing stock, we must report that no empirical confirmation of a problem of any substantial dimension has been found. Virtually none of the statistical tracks of such a problem appeared in any of the generalized data on the rent stabilized population or stock, and, though some faint signs of possible clustering of long staying households in a few buildings did appear in the specialized sample, they were not suggestive of any widespread problem even in a group of buildings that was hand-picked by owners to be representative of the problem. Therefore, although isolated instances of such concentrations may exist in some buildings, it seems quite unlikely that they are sufficient in number or intensity to threaten any appreciable long-term deterioration of the stabilized stock.

CHAPTER 7

POLICY CONSIDERATIONS AND RECOMMENDATIONS

The City has asked that the consultants provide, as but one of many inputs that the Council will consider in arriving at policy decisions, their own perspective on the principal policy issues raised by this study and their recommendations as to the appropriate City response. This Chapter presents these in summary form.

Policy perspectives and recommendations are necessarily subjective in nature. Facts such as those presented in the preceding Chapters may have different implications for different people. The views put forward herein are solely those of the individuals who prepared the study. They should not be identified with the City officials who commissioned the work, nor with any of the institutions which generated data that were used in the course of it. Responsibility for these judgments lies entirely with the authors of the Report.

The policy discussion is divided into four parts. First, we assess the overall suitability of the 1985 formula for setting the ceiling on rent increases, in light both of its performance to date and of the alternative economic environments in which it may be operating in the period immediately ahead. Second, we address the case for special exceptions or procedures for circum-

stances that have been advanced as examples of areas in which the system does not now function properly. Third, we identify topics that should receive special monitoring attention if the Council elects to continue with a system of something like the current design. Finally, we offer thoughts on the nature and timing of the next review of the impact of the Ordinance.

Should the Current Ceiling-Setting Method Be Retained?

In the judgment of the consultants, the formula for setting ceilings on rent increases in the stabilized housing stock has worked satisfactorily since it was adopted in 1985, and should be continued in force unchanged. This conclusion assumes that the other salient characteristics of the Los Angeles approach to rent regulation, most importantly the provision permitting landlords to mark the rent charged for a unit to the market price level when the unit is vacated, also remain in force. Taken together, these rules add up to a moderate regulatory regime which has been shown to maintain a good balance between protection of tenants from exploitive rents and maintenance of incentives to building owners to maintain and otherwise reinvest in their properties. Any change in the major counterweights in the system risks disruption of this delicate balance, which could result in serious damage to one of the City's most precious assets. The evidence suggests that the taking of such a risk is neither necessary nor prudent.

It seems beyond dispute that the CPI-based formula for setting annual ceilings on rent increases represented an improvement over the flat ceiling of 7% that preceded it. As shown in Chapter 3, the 7% ceiling would have been essentially irrelevant to the pricing behavior of building owners if it had been in effect in 1984-87, since it would have permitted average increases for all units that were equal in size to the unregulated increases that were actually charged only to new tenants. If such increases had been permissible throughout the system, the market probably would not have supported an average increase in stabilized rents as large as the ceiling would have allowed, but it would nevertheless have administered a stiff jolt to the longer-tenured, predominantly older households who were protected from a good part of that shock by the existence of the lower, CPI-based ceiling. At the same time, if the relatively low inflation rates that in fact obtained during these years had given way to another bout of rapid loss in the purchasing power of the dollar, a la the situation at the turn of the decade, the CPI-based formula would have allowed stabilized rents to rise even more than the 7% ceiling would have permitted them to increase. This combination of price sensitivity and flexibility seems much better suited to both the purposes of the Ordinance and its capacity to deal with changing economic circumstances than the 7% ceiling (or any other flat ceiling, for that matter).

Moreover, there is a good chance that these advantages may be even more important in the next few years than in the past three. The data presented in this Report depict a rental housing market operating in an environment of low general price inflation, rising rates of tenant mobility, a boom in construction of new multi-family housing, and increasing average vacancy rates in the stabilized stock. It is not unlikely that at least the latter two of these conditions may change in the years immediately ahead. We have detailed the many ways, ranging from reductions in tax incentives to increased controls on development, in which investment in new multi-family housing has been made less attractive in recent years. Therefore, whereas in the 1985 study we forecast that this type of construction showed strong signs of an incipient boom, we must now sound a note of caution about prospects on this front in at least the immediate future. It is no accident that all of the statistics tracing the boom seem to have turned down in the most recent year for which data are available. This may well prove a harbinger of things to come.

Without the outlet created by a construction boom, it is likely that vacancy rates in the stabilized stock will at least stop growing and perhaps begin to shrink, creating new pressures on rents within that stock. This probability is enhanced by the current strong surge in the average price of single-family homes, a surge that widens the financial gap between households for which the purchase of a house is a viable option and those for which it is not. Should these pressures arise in a period of

renewed general inflation, the ceiling on rent increases should be flexible enough to permit building owners to continue to receive a reasonable return on their investments despite the erosion of the dollar's purchasing power. Should they arise in the context of a recession, the ceiling should be capable of protecting non-moving tenants from the sharp increases in their rent-to-income ratios that could otherwise result from the tighter market. And, should the regional economy continue to be relatively strong and characterized by low to moderate inflation, the ceiling should permit the recent orderliness of the market to continue.

The CPI-based ceiling seems to us to meet all of these objectives, and to meet them more effectively than all alternative approaches that have been proposed thus far. It is arguable that the economic climate of the last three years has not provided the sternest test of the effectiveness of the formula. That test may well be in the offing. If so, our analysis concludes that the current formula, operating in the framework provided by the other key rules in the Los Angeles approach to rent regulation, remains the device best equipped to deal with new economic stresses. And, should such stresses not develop, the formula has proven its capacity to exert a reasonable degree of tenant protection without interfering with the vibrance of a thriving market. For these reasons, we recommend that the Council make no change in the method of setting ceilings on rent increases at this time.

Should New Exceptions Be Introduced Or Old Ones Abandoned?

The principal issues of this type that have been raised in the context of this review concern (i) a new exception to the ceiling for buildings with concentrations of "historically low rents;" (ii) a change in the rule under which rent increases are permitted upon proof that the building owner has made capital improvements; and (iii) introduction of special policies and procedures for dealing with housing for the often transient poor, principally in the form of Single Room Occupancy (SRO) hotel rooms. We will address each of these in turn.

With respect to historically low rents, the discussion in Chapter 6 documents what we consider a reasonably arduous effort to find empirical evidence that a problem of this kind exists in smaller buildings, and that it is of a scale sufficient to justify consideration of a new exception to the regulatory rules. This exploration was carried out despite our grave doubts that a technical case can be sustained to the effect that the rents charged prior to the 1978 freeze -- and adjusted, if appropriate, pursuant to the permitted onetime increase to remedy timing anomalies -- were "below-market" in any conventional sense of that term. This effort turned up no statistical evidence of any generalized problem, and very little basis for confirming its existence even in a special sample of buildings designated by their owners as cases in point. This analysis was not sufficient--

ly detailed to conclude that no such problem exists anywhere -- indeed, given the number of buildings in the system it almost certainly does exist somewhere. But we can conclude with confidence that if the problem is present, it has not created a degree of market disruption that threatens to create any measurable decline in the incentives to small building owners, taken as a group, to maintain or otherwise reinvest in their properties. Therefore, in our opinion, there is no sound basis in established fact to support a new exception to the regulatory rules.

Nevertheless, there remains one aspect of the historically low rents argument that may be worthy of a response from City regulators. This is the allegation that, for whatever reason, many small building owners did not learn or take advantage of the onetime increase of 13-19% that was permitted at the outset of the program to building owners who had not raised the rent charged for a unit during the previous 12-24 months. We have no information upon which to base an opinion as to the causes of this inaction, or who, if any single party, was most to blame for it. We also have no evidence bearing on how often it actually occurred. However, we are inclined to the view that if a building owner can provide convincing evidence that (i) it did occur in a particular case through no fault of his/her own; (ii) that the then resident tenant has not vacated the unit during the intervening decade; (iii) that the maximum allowable increase has been made in the rent for the unit in every year since the inception of stabilization, and that (iv) at least half of the units in the

building shared this experience, then the City should permit a special increase of the percentage originally specified to be made in the current rent charged for the unit. Any such increase should be spread over three years in order not to visit undue hardship upon the tenant (who is also presumably without fault in this matter) by having it take effect all at once.

The analysis in this Report suggests that there are not many situations in the stock which meet these criteria. But, to the extent that they do exist, this action by the City would permit the owners involved to gradually bring their rents up to the levels typical of those charged long staying households in the stabilized stock. These owners would not recover the income lost over the last 10 years. But whatever current and future disincentives to maintenance or reinvestment may be being exerted by the fact of an unadjusted base would be negated over a period designed to ease the transition for the tenant. With the sole exception of this type of situation, we do not recommend any exception to the current terms of the Rent Stabilization Ordinance to deal with concentrations of historically low rents.

Turning to the issue posed by the current allowance of rent increases upon proof of expenditure for capital improvements, we believe that the evidence supports continuation of this exception without amendment. The data presented herein make clear that both the average improvement cited and the average rent increase granted are small, and that the bulk of the upgrading of the

capital plant represented by the stabilized stock is very probably being financed from rent increases, particularly the marking of rents charged to new tenants to market levels, not by these special allowances. This confirms that the capital improvement program is not serving as a major loophole for large rent increases, but it also raises a legitimate question whether the program serves a useful purpose that would not be achieved without it.

Our judgment is that the program does serve a useful purpose, and that it is likely to be even more valuable in the event of the tighter market discussed above. In current market conditions, the program is probably making possible a non-trivial number of improvements in smaller, less prosperous buildings which would otherwise not be made. Since it is these buildings which probably pose the most serious danger of deterioration over time, incentives to improve them should not be reduced. Should the market grow tighter, it is likely that the program will become a more important financing vehicle for improvements, and thereby a more significant safeguard of the reinvestment incentives that are just as important to the overall success of the regulatory regime as are the limitations on rent increases. On balance, we see no compelling case for any change in the current approach to capital improvements, so we recommend none.

Finally, regarding the issue of effective regulation of rents charged in SRO hotels and other housing for the very poor, we defer the bulk of our comments until our separate, companion report that focuses solely on the function and economics of SRO buildings. However, two points need to be made here as well.

First, as noted in Chapter 3, it is a rightful matter of concern to policy makers that the rent-to-income ratios of households in the stabilized stock with less than \$10,000 in annual money income registered in this study as rising to a stratospheric average of 58%. The message conveyed by these data is simple: stabilized rental housing has become unaffordable for the very poor by anyone's definition of affordability. Even allowing for the non-monetary forms of benefits (e.g., food stamps, MediCal) that are available to such households, the share of their income now being consumed by rent necessarily displaces the purchase of other necessities to a degree that most Americans would not tolerate. And, the sharp increase in the average ratio in three short years indicates that the problem is rapidly getting worse.

Second, however, we believe that it should be recognized that rent stabilization is by nature a very inefficient method for dealing with problems rooted in poverty. The central objective of rent stabilization is to achieve and sustain the aforementioned balance between tenant protection and incentives for maintenance and reinvestment in the housing stock as a whole. To the extent that the rules and procedures of the program are

bent in order to accomplish the specialized task of redistributing substantial amounts of income to the very poor, the overall balance in the market is likely to be destroyed. In the admirable event that more help is to be offered to the poor, the efficient mechanisms for doing so lie on the income side of the equation, not in a program designed to stabilize the rental housing market.

Since the bulk of the income of such households is already in the form of public benefits of one kind or another, the instruments for providing a higher level of public assistance are readily at hand for governmental authorities (though largely at the State and County rather than the City level). And, at least in the case of rent stabilized housing (as distinct from SROs), if such increases in income are achieved, the stabilization system will help to avoid their being immediately consumed by sharp increases in rent.¹ However, if the rent stabilization program is to continue effectively performing the task set out for it in the Ordinance, it cannot and should not be expected to remedy the basic economic problems of the very poor. The implication of this Report in this topic area, therefore, is that the plight of the poor is getting worse by this as well as

¹The situation of SROs, whether rent stabilized or not, is unique and distinguishable, as discussed in the companion Report devoted entirely to them. See that Report for our policy recommendations regarding buildings of this specialized type.

virtually every other measure, not that the effective way to address that plight is through manipulation of City policy toward rent regulation.

What Aspects of the System Should Be Most Carefully Watched?

The City's Rent Stabilization Division monitors many aspects of the regulatory system and the condition of the stabilized stock and should, in our view, continue to do so. We would invite a special order of new attention to only two areas.

The first is the behavior of average density of population per room. Overcrowding is of concern because it accelerates the deterioration of the housing units involved. As shown in Chapter 2, the Los Angeles average density is not yet at the point that is usually defined as saturation (i.e., one person per room), but it is fast approaching that point. Moreover, since the figure is an average, it means that a great many households have higher densities. One of the downside risks of rent regulation that favors longer tenant tenure is that it tends to discourage movement to larger quarters as a household expands in size. This pressure is compounded by the fact that, as is evident from the statistics on new construction, the new unstabilized units tend to have more amenities (particularly more bathrooms), but relatively few of them are larger than two bedrooms. For large families, this means that both the incentive and the opportunity to move are declining. We believe that the implication of this

is that density developments bear careful watching, and may generate a need for Council action at some point in the foreseeable future.

The other recommended focus is on the rate of new construction. We have already stated our suspicion that this market may have begun to recede from the boom condition that it has enjoyed for most of the past three years, and that this decline has important implications for the state of the market for stabilized units. A carefully updated index of new starts and first rentals, like the one created by RSD in the context of this study, is likely to be among the most accurate predictors of the new stress in the stabilized market. We believe that the City's purposes would be well served if it were to establish and maintain such an index on an ongoing basis.

When and in What Form Should the Next Review Occur?

Virtually wherever rent regulation has been introduced, it has proven both politically and administratively necessary to conduct periodic analyses of its impact. Unlike some other forms of regulation, this one is simply too controversial an issue to permit many years to pass between evaluations of its continued appropriateness and effectiveness. This is no less true in Los Angeles than elsewhere.

We believe that this pressure for continual monitoring and reevaluation is not only inevitable but healthy. Should rent regulation ever become so entrenched and accepted that its impact is not subjected to regular review, that will be the time, in our judgment, when the most serious worry about attenuation of the incentives for maintenance and other reinvestment in the stock will be most justified. We do not, therefore, recommend that such reviews be terminated or separated by much longer intervals than has been true thus far.

Nevertheless, we do believe that, absent clear evidence of a crisis of some sort, general reviews of this kind cannot be productively conducted at intervals of less than three years. This conclusion follows not only from the expense and other wear and tear involved in assembling the data, but also from the premise that the Council views this area of policy as one that should be adjusted in major fashion only after a clear, factual demonstration either that conditions in the market have changed or that some other factor has intervened to create a durable need for some fundamental alteration in existing policy or procedure. By and large, again excluding sudden crises of large proportions, it is impossible to meet these preconditions of major amendment of the Ordinance without three years' worth of data documenting and confirming trends. In our view, therefore, reviews of the impact of the Ordinance should be commissioned by the City at

intervals of not less than three nor more than five years so long as the Council elects to continue a general program of rent regulation.

Turning from the timing to the substance of these reviews, our experience suggests that there are three primary data problems that need special attention in preparation for the next one and its successors. The first, and arguably the most serious, is the problem of getting information that accurately reflects the financial circumstances of all Los Angeles building owners. The sources used in the preparation of this Report -- the Institute of Real Estate Management and the State Franchise Tax Board -- generate data which, though quite useful, do not, as we have made clear, produce a rounded view that takes into account buildings of all types of ownership within the City, as against the SMSA. Likewise, the detailed survey of individual owners that was conducted in the course of the 1985 impact review suffered from the fact that it was hostage to a rate of landlord participation that was conditioned by a rush of publicity suggesting that it was a ploy engaged in as part of a predetermined campaign to lower the ceiling on rent increases. If these reviews are to continue, and are to serve as reliable bases for Council deliberations on policy, a more settled and reliable means of collecting data on landlord finances must be found.

One way of doing this would be to start now, at least three years before the next review, to identify a representative sample of buildings and seek the cooperation of the owners and their associations in an ongoing, highly confidential data gathering effort that would avoid the furor and consumption of landlord time that inevitably attends a special survey of landlord finances. This ongoing data collection effort could be supplemented by a small special effort at the time of the review, as well as cross-checked for plausibility against IREM and FTB data (as the 1985 landlord survey data were). This ongoing effort might result both in more reliable data and in less friction at the politically inflammatory point when the Council is known to be preparing to review the whole fabric of rent regulation policy.

The second major data/analysis problem that needs to be addressed in or before the next review is the proper measurement of the benefits of rent stabilization. Put another way, the issue is against what standard of behavior of unregulated rents should that of regulated rents be compared. The 1985 study used two alternative standards, one reflecting conditions in cities surrounding Los Angeles that did not adopt rent regulation and the other assuming that the tenure discounts that existed in Los Angeles in the year prior to enactment of rent stabilization had remained constant since. The current study uses only the latter standard. There is an arguable case that the next study should use this standard as well.

However, if the next review is based on data collected three years after the data for this one, i.e., in 1990, there will have been a 13-year interval since the last pre-stabilization year. The longer that interval grows, the more tenuous is the assumption that factors other than rent stabilization would not have intervened to change the structure of tenure discounts if stabilization had never been adopted. At some point, the growing weight of this argument will require the responsible analyst to attempt to trace the impact of non-stabilization factors on tenure discounts in Los Angeles and elsewhere, and to create a more textured non-stabilization world against which to measure the actual world of stabilized rents. A number of technical approaches could be used to do this, and this is hardly the place to discuss the technical details. However, it would be worth the City's time, in our judgment, to begin soon to determine what standard is likely to yield the most accurate measure of the volume and distribution of tenant benefits, and what data base is required in order to develop and apply it.

The third and final data/analysis focal point to which we would call attention concerns developments in the unstabilized stock. This study provides the first such information, and it demonstrates that there are considerable differences between the balance of demographic characteristics of stabilized and unstabilized households, as well as in the rents they pay. As the unstabilized stock has grown in size, detailed information about it has become almost indispensable to sensible analysis of the

situation and the prospects of the stabilized portion of the stock. It is also presumably of interest to policy makers to know to what extent the regulatory system is creating a dual market for rental housing in the City, and what level of actual and potential interchange there is for housing consumers as between the two. All of this will require continuation and perhaps expansion of data collection activities in the unstabilized stock. If that is to be the case, careful thought needs to be devoted to what level of sampling is needed in order to support the data and analytic needs that are determined.

In sum, we recommend that the City conduct reviews of the impact of the Rent Stabilization Ordinance within the maximum and minimum interval prescribed above, that it move now to try to develop a more accurate data base with respect to landlord finances and a more durable standard against which to measure benefits to tenants, and that it develop a strategy for inclusion of the unstabilized tenant household population in future reviews.

We thank the City for the invitation and opportunity to express these views on policy questions.

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